91-521 (1)

No. _____

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

BANCO POPULAR DE PUERTO RICO,
Petitioner,

v.

MUNICIPALITY OF MAYAGUEZ,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PUERTO RICO

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QUESTIONS PRESENTED

1. Is a municipal license tax, fashioned as a gross receipts tax, which exposes the taxpayer to multiple taxation because it does not provide an adequate basis for determining what portion of gross income derived from interstate operations is attributable to the taxpayer's operations in the taxing jurisdiction (in this instance, Puerto Rico), valid under the Commerce Clause of the U.S. Constitution?

2. Was the remedy fashioned by the Puerto Rico Supreme Court to cure the invalidity of the tax at issue herein a mere contrivance designed to insulate the question presented above from review by this Court?

LISTING OF PARENT COMPANY AND NONWHOLLY OWNED SUBSIDIARIES

The parent company of petitioner Banco Popular de Puerto Rico is BanPonce Corporation. Banco Popular de Puerto Rico does not have any nonwholly owned subsidiaries.

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Petitioner Banco Popular de Puerto Rico very respectfully prays that a writ of certiorari be issued to review two judgments of the Supreme Court of Puerto Rico. One of them was issued on March 14, 1988 and is unofficially reported as *Banco Popular de Puerto Rico v. Municipality of Mayagüez*, P.R. Bar Ass'n. Adv. Sh. 1988-26; 88 JTS 29; the other one, on rehearing, was issued on June 29, 1990, bears the same caption and is unofficially reported as P.R. Bar Ass'n. Adv. Sh. 1990-88; 90 JTS 99. Also subject to review but not reported at all is a June 28, 1991 summary denial of a second motion for rehearing. Before the Supreme Court of Puerto Rico, the case was docketed as no. RE-87-19. The 1988 judgment, the 1990 judgment on rehearing and the 1991 order summarily de-

nying further rehearing are reproduced as appendices A, B and C to this petition.

JURISDICTION

The dates of the judgments and order sought to be reviewed have been set forth above: March 14, 1988, June 29, 1990 (on rehearing) and June 28, 1991 (denying any further rehearing). This Court has jurisdiction to review these two judgments and order pursuant to 28 U.S.C. 1258, which provides:

> **§ 1258. Supreme Court of Puerto Rico; certiorari**
>
> Final judgments or decrees rendered by the Supreme Court of the Commonwealth of Puerto Rico may be reviewed by the Supreme Court by writ of certiorari where the validity of a treaty or statute of the United States is drawn in question or where the validity of a statute of the Commonwealth of Puerto Rico is drawn in question on the ground of its being repugnant to the Constitution, treaties, or laws of the United States, or where any title, right, privilege, or immunity is specially set up or claimed under the Constitution or the treaties or statutes of, or any commission held or authority exercised under, the United States.

CONSTITUTIONAL PROVISION INVOLVED

The constitutional provision involved in this case is the Commerce Clause, Art. I, Section 8, third clause, of the U.S. Constitution: "The Congress shall have power. . . to regulate Commerce with foreign Nations,

and among the several States, and with the Indian tribes;. . ."

STATEMENT OF THE CASE

A. The Statutory Framework

Pursuant to Puerto Rico law, a municipality is a political and juridical entity that includes the inhabitants living within its territorial limits, having full legislative and administrative powers in any matter of municipal nature, with perpetual succession, legal existence and personality, separate and independent from the government of the Commonwealth of Puerto Rico. 21 L.P.R.A. 2051.

The Puerto Rico Municipal License Tax Act, 21 L.P.R.A. Ss. 651-652y, enacted in 1974, authorizes all municipalities in the Commonwealth of Puerto Rico to levy on and collect from every person engaged in the rendering of any service, or in the sale of any goods, financial business and/or any industry or business, municipal license taxes. 21 L.P.R.A. 651b. Every person engaged for profit in the rendering of any service, in the sale of goods, in any financial business or in any industry or business in the municipalities of the Commonwealth of Puerto Rico is subject to the payment of municipal license taxes. 21 L.P.R.A. 651c. Payments on account of municipal licenses established under the Municipal License Tax Act are one of the municipalities' sources of income. 21 L.P.R.A. 3202(d).

For persons engaged in the financial business, such as commercial banks,[1] the municipal license tax may

[1] 21 L.P.R.A. 651a(a)(5).

not exceed 1% of its volume of business attributable to the municipality levying the license tax. 21 L.P.R.A. 651d(a). For commercial banks such as petitioner, "volume of business" is defined as follows:

> "(B) Financial business.-- Where financial business is involved, the volume of business shall be the gross income received or earned, excluding:
>
> "(1) cost of property sold;
>
> "(2) reimbursement of advances, loans and credits granted, but the sum deducted on this account shall not exceed the principal of said advances, loans or credits;
>
> "(3) the deposits; and
>
> "(4) losses incurred in any operation in securities, but the deduction made on that account shall not exceed the total amount of the profits obtained for said securities.
>
> "In the specific case of commercial banks and savings and loan associations, mutual or savings banks, the gross income shall mean the interest received or earned on loans, the fees for services rendered, the rents, the gross benefit in the sale of property or securities and the profits, benefits and income derived from any other source.
>
> "The gross income earned by these organizations subject to payment of licenses shall be distributed among the branches in accordance with the proportion of all kinds of

> deposits of the branch with the total deposits of the organization." 21 L.P.R.A. 651a(a)(6)(B).

The Secretary of the Treasury of Puerto Rico is authorized to prescribe and promulgate regulations necessary for the enforcement of the Municipal License Tax Act. 21 L.P.R.A. 652x.(a)(1). On August 24, 1984, approximately ten years after the Municipal License Tax Act was approved, he filed Regulation No. 3142, the "Municipal License Tax Regulation" (hereinafter, "Regulation No. 3142"). For commercial banks such as petitioner, art. 2(7)(B) defines "volume of business" as follows:

> "(B) Volume of Business -- Financial business.
>
> "Where financial business is involved, the volume of business shall be the gross income received or earned, excluding (a) cost of property sold, which means the cost of the real and personal property sold by the financial business. This includes stocks and other securities; (b) reimbursement of advances, loans and credits granted, but the sum deducted on this account shall not exceed the principal of said advances, loans or credits; (c) the deposits; and (d) losses incurred in any operation in securities, but the deduction made on that account shall not exceed the total amount of the profits obtained for said securities.
>
> "Banks--
>
> "In the specific case of commercial banks and savings and loan associations, mutual or sav-

> ings banks, the gross income shall mean the interest received or earned on loans, the fees for services rendered, the rents, the gross benefit in the sale of property or securities and the profits, benefits and income derived from any other source within or outside of Puerto Rico, attributable to the operation in Puerto Rico. Provided, however, interest on the obligations of the Commonwealth of Puerto Rico, its instrumentalities and municipalities as well as the obligations of the United States shall not be included as gross income.
>
> "The gross income derived by all financial organizations subject to the payment of the municipal license tax shall be distributed among the individual branches based on the deposits of such branches as a proportion of the total deposits of the organization."

As can be seen from the above quoted text, Regulation No. 3142 differs from the statutory text, in relevant part, in that it purports to make taxable gross income derived by banks from sources "outside of Puerto Rico, attributable to the operation in Puerto Rico". The Municipal License Tax Act does not contain any language which would otherwise explicitly provide that income derived by banks from sources outside of Puerto Rico would be subject to the tax; and neither the statutory text nor Regulation No. 3142 define or establish rules that may clarify what is meant by the phrase "attributable to the operation in Puerto Rico".

B. The Facts of the Case and its Disposition Below

Prior to the adoption of Regulation No. 3142, respondent served petitioner with a notice of municipal license tax deficiency for 1979-1980 and 1982-1983 in the amount of $102,009.61. Respondent alleged that petitioner had excluded from its volume-of-business computations in its municipal license tax returns the following items:

(a) Income derived from investments and operations outside of Puerto Rico in branches located in New York, California and the U.S. Virgin Islands;

(b) Income derived from investments in United States bonds; and

(c) Income derived from investments in Puerto Rico bonds.[2]

Upon a challenge by petitioner, the trial court held that the Municipal License Tax Act did not authorize municipalities to impose a tax on income derived beyond their respective territorial limits, and therefore declared null and void that portion of Regulation No. 3142, quoted above, which would tax a bank's gross income derived form sources outside of Puerto Rico.[3] The trial court thus set aside the notice of deficiency.

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[2] Both the trial court and the Puerto Rico Supreme Court held that both U.S. treasury bond income and Puerto Rico bond income were free from municipal license taxation. The correctness of this ruling is not at issue herein.

[3] This was not the first time that the Municipal License Tax Act was found to be offensive to the Commerce Clause. *See Sea-Land Services, Inc. v. Municipality of San Juan*, 505 F. Supp. 533 at 546-556 (D.P.R. 1980).

Upon request by respondent, the Puerto Rico Supreme Court accepted the case for review.

On March 14, 1988, the Puerto Rico Supreme Court issued its first opinion in this case. It held that municipalities could be empowered by the Legislature to tax income derived from sources outside of Puerto Rico, and that it indeed had provided such authority implicitly in the text of the statute quoted above. It therefore ruled that the extraterritorial provision of Regulation No. 3142 was valid, and that petitioner's income derived from its extraterritorial investments and operations (New York, California and the U.S. Virgin Islands) should be included in the computation of the municipal license tax.

Upon rehearing, the Puerto Rico Supreme Court issued its second opinion in this case on June 29, 1990. It found that the Commerce Clause challenge to the municipal license tax at issue herein had "the greater persuasive force." It recognized that, in order to be valid, a tax on income generated from interstate commerce had to avoid the risk of multiple taxation, and referred to this Court's decisions in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), *Tyler Pipe Industries, Inc. v. Washington Department of Revenue*, 483 U.S. 232 (1987) and *Goldberg v. Sweet*, 488 U.S. 252 (1989). It conceded that the municipal license tax at issue herein was "theoretically" unconstitutional due to the risk of subjecting petitioner to multiple taxation.

Nevertheless, the second opinion found that the day was saved when it held that the statute could be "interpreted" to recognize as a "credit" against the municipal license tax at issue the amount of any taxes paid by petitioner's branches in New York, California

and the U.S. Virgin Islands. It recognized that the statute did not expressly allow any credits for taxes paid outside of Puerto Rico, but felt that this "interpretation" of the statute was necessary "to insure the constitutionality of our Municipal License Tax Act against an attack pursuant to the commerce clause, since it eliminated the risk of double [multiple] taxation." The case was remanded to the trial court for the sole purpose of having petitioner show (and claim as a "credit") any taxes paid by its branches in New York, California and the U.S. Virgin Islands.

Associate Justice Hernández Denton dissented. He noted that under *Goldberg* all the standard of "internal consistency" required was a hypothetical showing of exposure to multiple taxation; the taxpayer did not have to prove any particular instance of multiple taxation. Thus, the dissent found that the remand ordered by the Puerto Rico Supreme Court was unnecessary since it was erroneous to require petitioner to show to the trial court any particular instance of multiple taxation. The dissent stated that the majority had "created", absolutely without any basis in the statute, a "credit" to avoid double taxation so as to frustrate this Court's review of petitioner's claims under the Commerce Clause of the U.S. Constitution.

Part IV of the majority opinion tries to meet the dissent's arguments by countering that the statute and Regulation No. 3142 contained an apportionment formula based on the ratio of deposits of a branch located in the municipality to the total deposits of the organization or bank. *See* 21 L.P.R.A. 651a.(a)(6)(B) and article 2(7)(B) of Regulation No. 3142. However, although the majority opinion refers to the "total deposits of the organization" in four different instances

(and this is, in fact, how the statutory provision reads), the opinion does state once that the formula is based on the ratio of each branch's deposits to the "total deposits of the financial organization *in Puerto Rico*" (emphasized). This restrictive statement would appear to be clearly at odds with the otherwise extraterritorial focus of the majority opinion, both in terms of income received from and deposits located in branches outside Puerto Rico.

Petitioner's second motion for rehearing was denied on June 28, 1991. A motion to stay mandate pending disposition of this petition was denied on July 24, 1991.

The Commerce Clause issue was not explicitly addressed by the trial court, since it declared null and void the extraterritorial clause added by Regulation No. 3142 on grounds that the statute had not expressly conferred such broad taxing powers on municipalities. The trial court therefore did not need to reach the constitutional issues raised by petitioner in its original complaint. Neither did the first opinion of the Puerto Rico Supreme Court reach or address the Commerce Clause issue in reversing the trial court on the matter of the extraterritorial scope of the tax base.

It bears emphasis that the statutory text is devoid of any explicit extraterritorial clause; that it is only in Regulation No.3142, adopted ten years following approval of the Municipal License Tax Act, that any such language first appeared; and that the first opinion held that the municipalities could be and indeed had been empowered by law to tax income derived from sources outside of Puerto Rico and actually received in Puerto Rico by the taxpayer. Petitioner is

thus faced with having to draw in question the administrative and judicial construction and elaborations upon a statute—and not the text of the Puerto Rican statute itself—on the grounds that, as so interpreted, the statute has now become repugnant to the Commerce Clause of the Constitution of the United States.

This issue has been raised before the courts below, and treated therein, as follows:

1. At part XIV of petitioner's May 20, 1987 brief before the Supreme Court of Puerto Rico;

2. As noted above, the March 14, 1988 judgment of the Puerto Rico Supreme Court did not address the Commerce Clause issue;

3. At part IX of petitioner's April 5, 1988 motion for rehearing before the Supreme Court of Puerto Rico;

4. At part VI of the June 10, 1988 brief of Banco de Ponce, as amicus;

5. At part II.C. of the June 27, 1988 brief of the Municipality of Arecibo, as amicus;

6. At parts III and IV of the Puerto Rico Supreme Court's June 29, 1990 opinion on rehearing, upholding the validity of the tax at issue under the Commerce Clause; and at part V of the dissent from said ruling; and

7. At part VIII of petitioner's July 9, 1990 second motion for rehearing.

REASONS FOR ALLOWANCE OF THE WRIT REQUESTED

A. The Decision of the Puerto Rico Supreme Court is in Direct Conflict with Applicable Decisions of this Court

In exercising its judicial discretion to review by writ of certiorari, this Court may consider whether a state court has decided a federal question in a way that conflicts with applicable decisions of this Court. Supreme Court Rule 10.1.(c).

Such is the situation at bar.

Since the decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court has consistently applied a four-pronged test for determining the validity of a state tax under the Commerce Clause:[4]

(a) The tax must be applied to an activity having a substantial nexus with the taxing state;

(b) The tax must be fairly apportioned, i.e., it must be internally and externally consistent. To be internally consistent, the tax must be structured so that if every state were to impose an identical tax, no multiple taxation would result. To be externally consistent, the state may only tax that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed;

(c) The tax must be nondiscriminatory against interstate commerce; and

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[4] Likewise under the Due Process clause.

(d) The tax must be fairly related to the services provided by the taxing state.

Wardair Canada, Inc. v. Florida Department of Revenue, 477 U.S. 1, 8 (1986); *D.H. Holmes Company, Ltd. v. McNamara*, 486 U.S. 24, 30 (1988); *Goldberg v. Sweet*, 488 U.S. 252 (1989); *Amerada Hess Corporation v. Director, Division of Taxation*, 490 U.S. 66, 72 (1989); *Trinova Corporation v. Michigan Department of Treasury*, 498 U.S. ___, 112 L.Ed. 2d 884, 903 (1991).

The 1990 decision of the Puerto Rico Supreme Court concedes, for all practical purposes, that the tax at issue herein fails to meet the second test, that of fair apportionment, because the tax is not internally consistent: ". . . due to the risk of multiple taxation, our Municipal License Tax Act may prove to be unconstitutional." However, instead of upholding the clearly permissible construction of the Municipal License Tax Act reached by the trial court, the Puerto Rico Supreme Court continued to adhere to an interpretation that forces an otherwise unwarranted constitutional question. On the thin reed of regulatory language which differed in both substance and style from the statutory text on which it purportedly relied, the Puerto Rico Supreme Court pressed forward to "remedy" the constitutional defects of the purported extraterritorial scope of the Municipal License Tax Act.

It is not at all clear, contrary to what the Puerto Rico Supreme Court has held, that the Municipal License Tax Act contains a foreign income apportionment formula. The regulatory provision which would allow taxation of income derived from sources outside of Puerto Rico adds the sole caveat that such income

must be "attributable to the operation in Puerto Rico". There is, however, no definition of how the *taxable* gross income is thereby determined. *Compare, Sea-Land Services, Inc. v. Municipality of San Juan,* 505 F. Supp. 533, at 553 (footnote 82) (D.P.R. 1980) (". . . the complete lack of guidelines of the 1974 and prior Acts, coupled with the intense and variegated interstate activity of plaintiffs within the municipalities, prevent us from embarking into what in this case would be a 'legislative' venture. We would be merely guessing the aspect of plaintiffs' activities whose exaction is intended.")

The Puerto Rico Supreme Court appears to avoid the issue of how the extraterritorial income is determined to be "attributable" to Puerto Rico operations by instead focusing on the statutory formula for distributing among the various municipalities the gross income which is deemed or found (on no definite basis) to be taxable. The last paragraph of 21 L.P.R.A. 651a(a)(6)(B) does not of itself appear to govern the apportionment of a bank's gross income between Puerto Rico and other jurisdictions wherein the same income could be taxed. Even assuming, *arguendo*, that it were to be so construed, then its reliance on the single factor of the ratio of branch deposits to worldwide deposits (the "total deposits of the organization"[5]) of the bank would still present the question of whether any resulting tax is fairly apportioned for purposes of Commerce Clause analysis. Neither the statute nor either of the opinions of the Puerto Rico Supreme Court adequately address the issue of what relation, if any, the "attributable" test

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[5] 21 L.P.R.A. 651a(a)(6)(B), art. 2(7)(B) of the Municipal License Tax Regulation.

could have to the deposit ratio "formula" for allocating taxable income among municipalities.

This chasm in the administrative and judicial "construction" of the statute can only serve to create confusion and inconsistent application of an apportionment test. Each of the 68 municipalities in Puerto Rico in which petitioner currently operates branches may seek to impose its respective municipal license tax on its own interpretation of what portion of petitioner's income derived from sources outside of Puerto Rico is properly "attributable" not only to each such municipality, but to petitioner's entire operations in Puerto Rico.

It seems ironic that in the face of a judgment by the trial court which had upheld a longstanding interpretation of the original text of the statute, the Puerto Rico Supreme Court then compounded the resulting confusion by reading, into a wholly inapposite provision of the statute, a so-called "credit" in order to render the statute constitutional. An unnecessary reading of a statute so as to render it unconstitutional then led to the creation of an alleged "remedy" having no statutory basis whatsoever. All of which leads us to the second issue presented for review.

B. The Decision Below does not Rest on an Adequate and Independent State Ground; Instead, the Remedy Fashioned by the Puerto Rico Supreme Court was a Mere Contrivance to Defeat Review by this Court of the Validity of the Tax at Issue Herein

After having interpreted the statute and municipal license tax regulation involved herein so as to render them unconstitutional, the Puerto Rico Supreme Court then felt bound to interpret another part of the statute so as to fashion a "remedy" for the invalidity of

the tax. The Puerto Rico Supreme Court held that, although the statute did not expressly recognize any "credit" for taxes paid elsewhere, there was an alleged ample basis to recognize a "credit" against the municipal license tax in the amount of the taxes paid by petitioner extraterritorially (presumably to New York, California and the U.S. Virgin Islands).

The allegedly ample basis for the recognition of this "credit" was discovered at 21 L.P.R.A. 652f(a)(1) and (c), which provide:

> **(a) Authorization.**
>
> (1) Excess payment.-- When payment has been made in excess of any license tax levied hereunder, the amount of said excess payment shall be credited against any tax or installment thereof enforceable at that time against the persons and any balance shall be immediately refunded to the person.
>
> . . . .
>
> **(c) Excess payment determined by the Superior Court.**-- If the Superior Court should determine that there does not exist any deficiency, and should further determine that the person has made an excess payment of tax with respect to the accounting year as to which the deficiency was determined by the Municipal Treasurer, or should determine that there exists a deficiency, but that the person has made an excess payment of tax with respect to said tax year, the Superior Court shall have power to determine the amount of said excess payment and said amount shall, when the decision of the Su-

> perior Court becomes final, be credited or refunded to the person. . . .

The "excess payments" to which the quoted sections refer can only mean "excess payments" made to Puerto Rico municipalities pursuant to the Puerto Rico statute ("in excess of any license tax *levied hereunder*"). Nowhere does the statute define "excess payments" as payments made to other states pursuant to such other states' laws, such as payments made to New York, California or the U.S. Virgin Islands pursuant to New York, California and U.S. Virgin Islands law.

The creation of the so-called "credit" by judicial fiat is merely a contrivance to try to defeat this Court's review of the validity of the tax at issue. The dissent below correctly denounced it as such, and thus it should not immunize the decision of the Puerto Rico Supreme Court from review by this Court. *See Michigan v. Long*, 463 U.S. 1032 (1983). After all, the "credit" invented by the Puerto Rico Supreme Court is, ironically, a reaction to its self-inflicted wound of reading a statutory and regulatory formula in such a way as to render the formula unconstitutional under the Commerce Clause.

C. Matters of National Concern

The distribution and apportionment of the various states' powers to tax transactions in interstate commerce by application of the Commerce Clause is a matter of national importance. This case presents to this Court the opportunity to further expound on this subject, this time in the context of banks with branches operating outside their home states. We have found no decision by this Court addressing this sub-

ject in the particular context of interstate branch banking. During the last term, in the *Trinova* case, this Court regarded "the applicability of a three-factor formula to a state income tax" to be "well settled," but granted certiorari to consider the question "whether a similar apportionment formula may be applied to a value added tax." 112 L.Ed. 2d 896.[6] Petitioner respectfully suggests that for a similar reason certiorari should be granted herein: to consider the question of the validity under the Commerce Clause of state taxation of multi-state branch banking activities.

Furthermore, going to this Court's jurisdiction, this case presents to this Court the opportunity to reject, as neither adequate nor independent, purported state law grounds which have no reasonable statutory basis whatsoever but rather consist of a mere device to defeat this Court's jurisdiction to review state court judgments.

CONCLUSION AND RELIEF SOUGHT

This Court should issue a writ of certiorari to review the aforementioned 1988 and 1990 decisions and 1991 order of the Puerto Rico Supreme Court, as petitioner hereby very respectfully demands.

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[6] More recently, the Court has granted review in a case where a property tax was summarily upheld against a challenge based, *inter alia*, on the Commerce Clause and the *Complete Auto Transit* case. *R.H. Macy & Co. v. Contra Costa County*, 276 Cal. Rptr. 530, 541 (1990); *review granted* on June 3, 1991, case no. 90-1603. 59 U.S.L.W. 3809. In contrast, review was denied on June 17, 1991 in case No. 90-1627, *Commissioner of Revenue Services of Connecticut v. SFA Folio Collections, Inc.*, where the Supreme Court of Connecticut had found invalid, under the Commerce Clause, certain sales and use taxes. 59 U.S.L.W. 3838.

Respectfully submitted,

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September 26, 1991

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APPENDIX

APPENDIX A

AT THE SUPREME COURT OF PUERTO RICO

RE: 87-19

BANCO POPULAR DE PUERTO RICO
Plaintiff-Appellee

v.

MUNICIPALITY OF MAYAGUEZ
Defendant-Appellant

ON WRIT OF REVIEW
PER CURIAM

San Juan, Puerto Rico, March 14, 1988.

I

Does the calculation of a municipal gross receipts tax of a Bank include the income received from interests from investments in securities outside the demarcation of Puerto Rico and debentures which are tax exempt?

These questions were posed pursuant to the Municipal Gross Receipts Tax Act, No. 113 of July 10, 1974, 21 L.P.R.A. secs. 651 et seq when the Municipality of Mayaguez notified Banco Popular de Puerto Rico a deficiency of $102,009.61, corresponding to the years 1979-80 to 1982-83.

The aforementioned law requires that all persons subject to the payment of the gross receipts tax render every year to the municipality a statement of volume of business, including, inter alias, the volume of business during its prior accounting year which is taken as a basis for the calculation [21 L.P.R.A. secs. 651 (i) and (f)]. The municipal

action occurred pursuant to the general definition for *gross income* contained in the "Municipal Gross Receipts Tax Regulations", No. 3142, approved on August 10, 1984, of the Secretary of the Treasury. The deficiency was primarily the result of Banco Popular's not having included in the *gross income* in the computation of the volume of business of its local branch the income derived from investments and operations of its capital made outside the territorial demarcation of Puerto Rico in branches in the Virgin Islands and the States of California and New York, and also, investments in bonds and securities of the Government of the United States and its federal agencies and the Commonwealth of Puerto Rico, its agencies and political subdivisions.

Before the Superior Court, San Juan Part, the Bank questioned the deficiency. Said forum annulled it and declared the aforementioned Municipal Gross Receipts Tax Regulation referred to be void; at the request of the Municipality we review.

II

"We have to affirm with Maxime Leroy that the State is too big, too burdensome, too detached from the immediate needs and, therefore, a more proximate juridical organism is required, more in contact with local problems in conditions adequate to properly attend all those which are the result of neighborhood contact. This juridical entity is the one which we call Municipality", Fernando Albi, *Derecho Municipal Comparado del Mundo Hispanico,* Aguilar, 1955, page. 21. This citation contains the reason for the existence and primary goal of the municipalities: to satisfy the public needs which are proper to the local community. In short, it deals with the creation of an entity through which the state can take care of in the most effective manner "the social and economic welfare of a specific neighborhood conglomerate, pursuant to its particular needs and urgencies". Colon v. Municipality of

Guayama, 114 D.P.R. 193, 199 (1983); *Vélez v. Municipality of Toa Baja,* 109 D.P.R. 369 (1980).

The genesis and attributes of every municipality is the work of the Legislative Assembly, which constitutionally has the "faculty to create, suppress, consolidate and reorganize municipalities, modify its territorial limits and decide with regard to its regime and function; and [can] authorize them, also to develop general welfare programs and to create those organisms which are necessary for such purpose." Sec. 1, Art. VI, Constitution of the Commonwealth of Puerto Rico.

The municipalities lack the inherent power to impose taxes. Through a clear and express mandate the Legislature can delegate this faculty. *Robert v. Sancho Bonet, Treas.,* 58 D.P.R. 198 (1941). To that effect, at present, the Organic Act of the Municipalities—No. 146 of June 18, 1980, 21 L.P.R.A. Sec. 2001 et seq,—as a general rule recognizes the power of municipal taxation within its territorial limits and with regard to matters which are not incompatible with the taxation imposed by the State pursuant to Act No. 113 of July 10, 1974, 21 L.P.R.A. sec. 651, et seq. Under this design, and to attend to its budgetary needs, the Legislative Assembly authorized the Municipal Assembly to impose and collect a gross receipts tax according to the provisions of said law to "all persons engaged for profit purposes in rendering any service, in the sale of any financial business and/or (sic) any industry or business, in the municipalities of the Commonwealth of Puerto Rico.": Sections 3 and 4 of Act No. 113, 21 L.P.R.A. secs. 651 (b) and (c).

III

In the past there prevailed a restrictive approach with regard to the statutory interpretation of the municipal power to impose taxes. It was accepted that its sphere of action should not implicitly extend, nor by analogy should

its operation expand to encompass matters not specifically stated. *Cortada v. Municipality of Ponce*, 47 D.P.R. 615, 630 (1934); *Robert v. Sancho Bonet, Tres., supra*, McQuillin, *The Law of Municipal Corporations*, 3rd. Ed. 1986, Sec. 44.13; E. Cordova, *Curso de Gobierno Municipal* Editorial Universitaria (1984), pages 341-346; Genovevo Meléndez Carrucini, *Organismos Impositivos de Puerto Rico—Facultades Comparadas*, 18 Rev. Jur. U. I., (1983), pages 27-45.

However, shortly after the approval of the new Municipal Gross Receipts Tax Act which we are dealing with, this approach started to reflect a change. In *Molinos de Puerto Rico v. Municipality of Guaynabo*, 105 D.P.R. 470, 474 (1976), we listed the historical doctrinal antecedents and summarized the new position as follows:

> "The Gross Receipts Tax Act of 1914 contained a restrictive enumeration; the 1971 Gross Receipts Tax Act contained a non-restrictive enumeration and empowered the municipalities to classify and include other commerce, businesses or industries not listed; the Gross Receipts Tax Act of 1974 in effect eliminated the enumeration and granted a general faculty on the municipalities to impose and collect gross receipts taxes at the rates that said law prescribes or at a uniform "x" percent of said rates that the Municipal Assemblies determine. Secs. 3, 4 and 5 of Act No. 113 of July 10, 1974.
>
> *During the last years there has been a trend of thought, non-exclusive of course, which favors the expansion of the taxing power of the municipalities.* This is the reverse of the coin of that trend which favors the return of a series of powers to the municipalities. Practically in all cases the exercise of a power or of a faculty by a public entity entails the distribution of funds. From

> there arises this tendency which favors the expansion of the taxing power of the municipalities. Naturally this is a complex problem of public policy full of concomitancies and it corresponds to the Legislative Assembly and not to the Judicial Power to make the decisions it deems pertinent. However, as we stated in *Texaco Co. (P.R.) v. Municipality,* 81 D.P.R. 499, 509 (1959), we are not justified in adopting restrictive standards 'against the taxing power of the municipalities, in light of the clear and unequivocal expressions which from time to time the Legislative Assembly has been making in order to strengthen, instead of weaken, the taxing power of the municipal governments granted in the Gross Receipts Tax Act.' When there exists the authority of law to do so and except in inherently suspicious cases, we are not inclined to intervene with municipal economic regulation, since as we have stated, this is primarily a legislative function, *City of New Orleans v. Dukes,* 49 L. Ed. 2d 511 (1976)."

Subsequently in *Arecibo Bldg. v. Municipality of Arecibo,* 115 D. P. R. 76 (1984), we rafitied this more comprehensive view. In interpreting Sec. 3 of the Gross Receipts Tax Act we stated that from the "text of the law it can be seen that the authority granted to the municipalities is broad. The utilization of the words 'every person', 'any service', 'any industry or business', do not allow the restrictive interpretation, as appellant would have it." Id. 78.

IV

With this perspective in mind, we first of all concentrate on the municipal claim, that the law authorizes it to consider, as part of the gross income of a bank, income received from investments made beyond its territorial limits

with capital generated in Puerto Rico.[1] As indicated previously, the general rule is that the municipalities can only collect taxes for income derived from ". . . the specific operation that the industry or business will carry out within its jurisdiction". *Coca Cola v. Municipality of Aguadilla*, 99 D. P. R. 839, 841 (1971). To impose an assessment for gross receipts tax on the gross income derived from business outside its jurisdiction, it is indispensable that the legislature delegate such a power in an express, clear and precise manner.[2] Several reasons contribute to this.

First, the collection of municipal revenues extraterritorially potentially entails serious problems. If a "municipality could exercise this power in an unlimited manner, it is evident that an internal upheaval could occur within the state, a situation of lack of control or imbalance in the imposition of taxes which could even affect the sources itself of wealth of a nation. Consequently, the fundamental law of each country should consecrate the right of the municipality to establish its own taxes, but at the same time it should leave to the ordinary law the determination as to how that power should be coordinated with the public treasury of the state, *be it avoiding an irrational double tax on the same matter, be it establishing limits on the local tax in order to make its coexistence with the general tax feasible and viceversa.*" (emphasis ours) Cordova, ob. cit., pages 342-343.

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[1] In the present Municipal Gross Receipts Tax Act, savings and loan associations are specifically included as businesses subject to gross receipts tax. [21 L.P.R.A. sec 651(a)(5) and 6(b)]. See *Municipality of Guayama v. Ponce Fed.Savings*, 105 D. P. R. 285 (1976).

[2] *Commercial National Bank of Chicago v. City of Chicago*,432 N. E. 2d 227 (1982); *City of Evanston v. Create, Inc.*, 421 N.E. 2d 196 (1981); *Mobil-Teria Catering Company, Inc. v. Spralding*, 576 S.W. 2d 282 (1979); *City of St. Louis v. Lee*, 132 S.W.2d 1055 (1939); *City Stores Corp. v. City of Philadelphia*, 103 A.2d 664 (1954), McQuillin, ob. cit., sec. 44.91, Cordova, ob. cit. pages 341-345.

Second, the municipal taxes on the industry and commerce respond to the premise that the businesses located in their territory derive a benefit from the local organization to carry out their business activities and therefore they contribute to sustaining same. The crucial determination is if the economic event or the source of the financial business which generates said income is within or outside its municipality. *Mobile-Teria Catering Co. Inc. v. Spralding,* 576 S. W. 2d 282 (1979); *District of Columbia v. Johnson & Wimsatt, supra,* Cfr. McQuillin, ob. cit., secs. 44.191-44.193. And third, the uncoordinated imposition of taxes for municipal gross receipts taxes on extraterritorial sources of income, could have an excessively onerous tax multiplier effect on the industries or businesses comprised in the law.

The present Municipal Law contains sufficient language on which to support the thesis that a municipality can tax the income of the banks once they are received in Puerto Rico, even if they are derived from sources outside the territorial demarcation. To that effect, sec. 2(a) (6)(a) and (b) of the law defines the following terms as follows:

> "(6) Volume of business--
>
> (A) General Rule.—The term 'volume of business' means the gross income which is received or earned by rendering any service, from the sale of any assets, or by any other industry or business in the municipality where it maintains offices, warehouses, branches, manufacturing, container, bottling, processing, preparation, confection, assembly, extraction plants, place of construction or any other kind of industrial or commercial organization to conduct business on its behalf, without considering its profits or earnings.
>
> (B) Financial business--When dealing with a financial business the volume of business will be

> the gross income received or earned excluding: (1) the cost of the property sold; (2) the reimbursement of advances, loans and credits granted, but without the sum deducted for these items exceeding the principal of said advances, loans or credits; (3) deposits; and (4) the losses incurred in any operation for securities, but without the deduction being made for this item exceeding the total profit earned for said securities.
>
> In the specific case of commercial banks and savings and loan associations, mutual savings bank, gross revenue will mean the interest received or earned from loans, the service charges, the revenue, the gross earnings from the sale of properties or securities, and the profits, earnings and income derived from any other origin.
>
> The gross income derived by these organizations subject to the payment of gross receipts tax *will be distributed among the branches according to the proportion all the types of deposits of the branch bear to the total deposits of the organization.*" Emphasis added, 21 L.P.R.A. sec. 651(a).

From the reading of this provision it appears that the Legislative Assembly deemed as part of the gross income of the banks the "income derived from any other source" and, by the nature of that industry, it created the rule of proportional distribution among all the branches on the Island of "the total deposits of the organization". In investigating the scope of this provision we notice that the key word is "source", the meaning of which is "origin". Thus read, the municipal gross receipts tax encompasses "the profits, earnings and income derived from any origin". The determinant and taxable event arises when that income is received by the bank in Puerto Rico, with regard to investments whose genesis was its capital. In this as-

pect, the regulation of the Secretary of the Treasury is correct, that Art. 2(7)(A) and (B) of Regulation No. 3142, contemplates said taxing power by defining "gross income" as "*all the income from sources within or outside Puerto Rico that is received or earned in the operation that is carried out in each Municipality,* including all the additional income such as interests and dividends attributable to the operation." (emphasis added). The economic event—receipt of income—occurs within the territorial demarcation of the municipality within which it operates and benefits from municipal services.

To summarize, in the case of banks, the Municipal Gross Receipts Tax Act clearly reveals that the Legislative Assembly had the intention of extending the taxing power of the local municipal government, expanding the statutory umbrella, when it subjected the payment of the gross receipts tax to the income and earnings originated not only within the jurisdictional geographic demarcation of the municipality, but to the income received even if derived from the operations of the bank outside Puerto Rico. Its execution and payment will be through the formula of proportionality. As a result of this, the lower court erred in declaring null and void that part of the Regulation of the Secretary of the Treasury No. 3142, Art. 2(7)(A) and (B), which considers as part of the gross income of a Bank the income derived from sources "outside Puerto Rico which are received or earned in the operation in each municipality." As to this, the judgment should be modified.

V

We only need resolve with regard to the local and federal government bonds and debentures. In this aspect, we note that we are truly facing a tax.

> "There are several factors to be considered in determining if an exaction is a fee for a regulatory license or a tax for public revenues. In

general, the nature and purpose of an ordinance imposing an exaction and the nature and purpose of the ordinance or the statute authorizing the ordinance will determine the nature with regard to the character of the exaction.

Therefore, a statement or the evident purpose of regulating, even though it is not controlling or conclusive, tends to suggest that we are dealing with an exaction established purely for the purpose of regulating licensing fees. But an ordinance without provisions to regulate and impose an exaction, constitutes a tax ordinance designed to collect income, especially when the proceeds from the licensing fees are placed in the general funds or accounts of its budget. *When they are taxes solely for public revenues, the fees or charges for the license are taxes and can only be sustained if they are based on the power to impose taxes.*

The name that describes the exaction is irrelevant to determine if we are dealing with a regulatory fee or a tax to collect public revenues. In its stead, the characteristics of exaction should be taken into consideration in determining its true nature." McQuillin, ob. cit, sec. 26.18 (emphasis and translation ours)

We have seen how the Municipal Gross Receipts Tax Act establishes that the "proceeds of same [the gross receipts tax] will be used to cover the needs of its budget." In the case at hand[3] the municipal gross receipts tax has no other purpose than that of collecting revenues for the municipality. Cfr. RCA v. Government of the Capital, 91

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[3] Distinguishable from the case of *Municipality of Carolina v. Caribe Air Atlantic, Inc.*, 111 D.P.R. 943 (1974) where by way of *obiter dictum* we stated that the municipal gross receipts tax was not a tax.

D.P.R. 416, 439 (1964). As a tax, the municipalities are barred from considering as part of the gross income of the business to calculate the municipal gross receipts tax, the income derived by the bank resulting from bonds and securities of the federal Government and the Commonwealth of Puerto Rico, their agencies, corporations and political divisions.

Art. 3 of the Federal Relations Act, in its pertinent part states:

> ". . . and if necessary to anticipate taxes and revenues to protect the public credit, Puerto Rico or any of its municipalities may issue bonds and other debentues pursuant to the law; and all the bonds issued by the Government of Puerto Rico, or by its authority, *will be exempt from taxes by the Government of the United States, the Government of Puerto Rico, by any political subdivision or municipality of same, or* by any State, Territory or possession, or by any county, municipality or other municipal subdivision of any State, Territory or possession of the United States or the District of Columbia." Volume 1 L.P.R.A. (emphasis added)

It is evident then, that the Legislative Assembly of Puerto Rico lacks authority to impose taxes on the bonds and debentures of the Government of Puerto Rico or those issued under its authority. As a corollary said delegation to the municipalities is non-operative or non-existent. Thus, Art. 11 (25) itself of Regulation No. 3142 of the Secretary of the Treasury recognizes that "the interest on debentures of the Commonwealth of Puerto Rico and its instrumentalities and municipalities and the interests from the debentures of the United States" are exempt of taxes for purposes of the municipal gross receipts tax."

Insofar as the bonds issued by the United States of America is concerned, federal law exempts said debentures

(31 U.S.C. sec. 3124). Said rule prevents a state from imposing a tax onus which is higher than that of the holders of similar state debentures, since if this should occur, the state tax would be discriminatory and invalid. Cfr. *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983).

We conclude that the Legislative Assembly of Puerto Rico lacks authority to impose taxes on the bonds and other debentures issued by the Government of Puerto Rico or by its authority. Therefore, the legislature cannot delegate said power on the municipalities. Insofar as bonds and debentures issued by the Government of the United States or by its authority are concerned, they are excluded from all taxes as a result of the Municipal Gross Receipts Tax. To decide otherwise would be tantamount to configurating a situation of discrimination as contemplated in the federal law.

The corresponding judgment will be issued.

JUDGMENT

San Juan, Puerto Rico, March 14, 1988.

Pursuant to the grounds stated in the preceding Opinion, which is made to form an integral part of this one, Judgment is issued and the one issued by the superior Court, San Juan Part, dated December 9, 1986 is modified in order to resolve that having included non-exempt income received by Banco Popular derived from capital investments and operations made in its branches in the Virgin Islands and the States of California and New York in the calculation of the municipal gross receipts tax corresponding to Banco Popular de Puerto Rico for the years 1979-80 to 1982-83 is valid.

Thus modified, it is confirmed. The necessary proceedings compatible with what is resolved herein will continue in the lower forum.

Thus was pronounced and ordered by the Court and certified by the General Clerk. Associate Justice Mister Rebollo López dissented without written opinion.

Bruno Cortés Trigo
Chief Clerk

CERTIFIED To be a true and correct translation from its original.

/s/ Aida Torres

AIDA TORRES, CERTIFIED INTERPRETER ADMINISTRATIVE OFFICE OF THE UNITED STATES COURT 9/5/91

APPENDIX B

AT THE SUPREME COURT OF PUERTO RICO

RE-87-19

Banco Popular de Puerto Rico
Plaintiff-Appellee

vs.

Municipality of Mayaguez
Defendant-Appellant

On Writ of Review

Opinion of the Court issued by Associate Justice Mr. Negron Garcia (in Reconsideration)

San Juan, Puerto Rico, June 29, 1990.

We resolve the reconsideration filed by Banco Popular de P. R. to the *Per Curiam* opinion issued on March 14, 1988. During this stage, we have the benefit, in its capacity as *amicus curiae*, of Banco de Ponce. In essence three constitutional issues are raised under the due process of law, equal protection and interstate commerce clauses. Let us examine their merits.

I

First, it is alleged that the Municipal Gross Receipts Tax Act, 21 L.P.R.A. secs. 651 et seq., does not comply with the requirements of substantive due process of law. This is not correct.

In matters of economic legislation the constitutional guarantee of due process of law only requires that the law being attacked be rationally related to some legitimate

objective of the State. In order for said legislation to be declared unconstitutional it is required that it be arbitrary and that it not bear any rational relationship whatsoever to the purpose that is being pursued. *Salas v. Municipality of Moca,* res. on November 18, 1987; *Morales v. Lizarribar,* 100 D.P.R. 717 (1972); *Roig v. Junta Azucarera,* 77 D.P.R. 342 (1954). Under this doctrinal body, the present Municipal Gross Receipts Tax Act is fully justified by important reasons of public order. The means used to achieve its objectives are reasonable. Its legitimate purpose is to economically help all municipalities, particularly those in precarious fiscal situations. As we held, the expansion of the framework of activities over which taxes could be imposed—pursuant to legislative intent—is certainly a reasonable means to achieve its objectives.

On the other hand, in cases of fiscal legislation, so that the state can impose a tax on income generated in interstate commerce, the due process of law clause demands the concurrence of conditions: (a) minimal contact between the interstate activity and the taxing state; and (b) a rational link between the income that is attributed to the state for tax purposes and the securities which the taxpayer has within the taxing state.

Both conditions are complied with in the case at hand. The income generated outside Puerto Rico is attributed *indirectly* to the financial activities carried out in the Bank located in the municipality. The deposits of the local Bank form part of the general volume of money that is invested and generates income outside Puerto Rico. In view of this, that income generated outside Puerto Rico proportionally has an origin in the municipality. Furthermore, the formula of taxation contained in the law is fair, since the volume of business is determined taking into consideration the proportion of the deposits of the Bank located in the municipality with the total deposits of the financial organization.

In view of this first statement, reconsideration is denied.

II

In the second constitutional allegation, it is alleged that the Municipal Gross Receipts Tax Act creates an impermissible classification—between financial businesses and non-financial businesses—under the equal protection clause of the law. This is also incorrect.

As stated above, in the area of legislation of an economic nature, the Legislative Assembly has ample discretion to establish classifications, provided they are reasonably related to the purpose of the Law. Under said design, the classification is valid if any situation which will justify it can be conceived. *M.&B.S. Inc. v. Dept. of Agriculture*, 118 D.P.R. 319 (1987); *Wackenhut v. Rodriguez Aponte*, 100 D.P.R. 518 (1972).

Such is the situation before us. The peculiar nature of the financial activity justifies a different treatment with regard to the elements which constitute gross income and its formula of taxation. In view of this, the classification created by the law finds a rational basis on the nature of the banking organization which is *characterized by its functioning through branches within and outside Puerto Rico.*

III

It is alleged that the Municipal Gross Receipts Tax Act and its regulation, as applied, violate the interstate commerce clause. This constitutional argument is the one that is most persuasive. Let us see.

Today interstate commerce is not immune to the power of taxation of the states. However, for a legislation which imposes a tax on income generated in interstate commerce to be valid, it should avoid the risk of *multiple taxation.*

Prior to the leading cases of *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) and *Tyler Pipe Industries, Inc. v. Washington Dept. of Revenue*, 483 U.S. 232 (1987)—so that an allegation of double taxation could prosper—the taxpayer had to *affirmatively* demonstrate that some other state was imposing a tax on the same income derived from interstate commerce. Tyler[1], supra, 242, reiterates what is resolved in *Armco, supra,* and thereby rejected the prior doctrine.

> "General Motors does not constitute a precedent. As we have already advised, in that case the result did not depend on the decision of the Court as to whether the tax was or was not onerous for interstate commerce. Our reason not to rule upon this point was that the taxpayer 'had not demonstrated in what specific sense in constitutional terms [the tax of other states] was onerous for identical shipments as to which Washington measures its taxes', 377 U.S. at page 449. That is, *when General Motors was adjudicated, the Court required that the taxpayer had to prove that the specific interstate transactions were being subject to multiple taxes in order to be able to claim the existence of discrimination.* See also, Standard Pressed Steel Co. v. Washington Revenue Dept., 419 U. S. 560, 563 (1975) (which rejects a claim under the commerce clause because the taxpayer did not prove the risk of multiple taxes). However, in Armco, we categorically rejected that requirement. The fact that the tax on gross income in Washington is unconstitutional from its face cannot be alleviated through the examination of the effect of the legislation

[1] In *Tyler*, legislation which allowed a person who sold all his production inside the state to pay solely a sales tax—being exempt from the production tax—while if the person also sold outside the state he had to pay both taxes, was invalidated.

> approved in sister states. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 276-278 (1978)." (Translation and emphasis ours.)

However, it should be stated that in Armco as well as in Tyler, the legislation contested was discriminatory on its face. In view of this, until the case of Goldberg v. Sweet, 488 U.S. 252 (1989), it remained doubtful whether the new doctrine applied also to situations where the statute was not discriminatory on its face.[2]

In Goldberg, the Supreme Court of the United States ended said uncertainty by applying the criteria of internal and external consistency to a tax that was not discriminatory on its face.[3]

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[2] This uncertainty provoked in the *Tyler* case concurrent opinions from Justices Scalia and O'Connor. Of particular interest is that of Justice O'Connor who understood that it should be limited to those cases where the law contested was discriminatory on its face. She stated:

> "I subscribe to the opinion of the Court which sustains that 'in view of the fact that the exemption of the multiple activities is discriminatory on its face' *ante*, at page 11, see *Maryland v. Louisiana*, 451 U.S. 725, 756-757 (1981), taxpayers in Washington do not have to prove the existence of a discriminatory impact 'through an examination of the taxes used by other states'. *Ante* at page 14. I do not interpret the decision of the Court as if it extended the criteria of 'internal consistency' described in *Armco Inc. v. Hardesty*, 467 U.S. 638, 644-645 to taxes which are not discriminatory on their face, *contra*, post. at page 4 (SCALIA, J., concurrent opinion in part and dissenting in part) and would also not be in agreement with said result in this case. See *American Trucking Assns., Inc. v. Scheiner*, 483 U.S. 266 (1987)."

[3] The analysis of internal consistency requires that the tax under attack be structured in such a way that if each state were to impose an identical tax the phenomenon of multiple taxation would not exist. On its part, the one on external consistency consists in examining if the state has taxed only that portion of the income derived from in-

In light of these criteria and due to the risk of multiple taxation, theoretically our Municipal Gross Receipts Tax Act could be unconstitutional.

Notwithstanding this, in evaluating the decisional alternatives, we note that there exists a reasonable interpretation for said law which would allow us to maintain its constitutionality. This legislation, despite the fact that it does not expressly grant any credit for taxes paid outside Puerto Rico, authorizes that when a payment has been made in excess of any gross receipts tax, "the amount of said payment in excess will be credited against any gross receipts tax on the volume of business or part of same then demandable from the person and any remainder will be immediately reimbursed to the person." 21 L.P.R.A. sec. 652 f(a)(1). To that effect the statute provides that "the Superior Court will have jurisdiction to determine the total amount of said payment in excess, and said payment shall be, when the decision of the Superior Court is final and unappealable, credited or reimbursed to the person." 21 L.P.R.A. sec. 652 f(c) Without doubt, there is more than enough basis in the Municipal Gross Receipts Tax Act to recognize under it a credit for taxes paid by the branches outside Puerto Rico. In matters of constitutional hermeneutics, it is a firmly established principle that "the Judicial Power—in deference towards the Legislative Power—should make an effort to achieve interpretations which are congruent and compatible with the maintenance of the constitutionality of a law." P.R.P. v. C.W.P.R., 115 D.P.R. 631, 642 (1984); Milán Rodríguez v. Muñoz, 110 D.P.R. 610, 618 (1981).

The credit which we today recognize via interpretation—not creation nor legislation—has the purpose of securing the constitutionality of our Municipal Gross Receipts Tax Act before an attack under the interstate commerce clause, since it eliminates the risk of incurring in double taxation.

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terstate commerce which reasonably reflects the in-state component of the activity taxed.

IV

Before concluding, and in light of the grounds stated in the dissenting opinion of Associate Judge Mr. Hernández Denton, certain clarifications are necessary.

First, the source which confers on the Municipal Assemblies the authority to impose a gross receipts tax on financial businesses in their municipality is the law itself. It eliminated all limiting references in geographical terms. See Section 4 of the Act which suppressed the restrictive language of "the operations in Puerto Rico." Said gross receipts tax should be calculated taking as a basis the volume of business during its accounting year immediately prior to the date of the statement. On the other hand, in Section 2, it defines as a general rule the concept "volume of business" and when dealing with a financial business, in the following manner:

> (A) General Rule—The term 'volume of business' means the gross income which is received or earned by rendering any service, from the sale of any goods, or by any other industry or business in the municipality where it maintains offices, warehouses, branches, manufacturing, container, bottling, processing, preparation, confection, assembly, extraction plants, place of construction or any other kind of industrial or commercial organization to conduct business on its behalf, without considering its profits or earning.
>
> (B) Financial business—When dealing with a financial business the volume of business will be the gross revenue received or earned excluding: (1) the cost of the property sold; (2) the reimbursement of advances, loans and credits granted, but withou the amount deducted exceeding the principal of said advances, loans or credits granted; (3) deposits; and (4) the losses incurred

in any operation on securities, but without the deduction being made for this item exceeding the total earnings obtained for said securities.

In the specific case of commercial banks and savings and loan associations, mutual savings bank, gross income will mean the interest received or earned from loans, the service charges, the revenues, the gross profit from the sale of properties or securities, and the profits, earnings and income derived from any other origin.

The gross income derived by these organizations subject to the payment of gross receipts tax *will be distributed among the branches according to the proportion that all the types of deposits of the branch bear to the total deposits of the organization."* 21 L.P.R.A. sec. 251 a (6) (B)—emphasis added—.

Under both provisions we reach the same conclusion: income received in Puerto Rico from external sources are included in the calculation of volume of business.

In addition to the general rule, from the last paragraph of subsection (B) it clearly appears that in the specific case of banks the law itself establishes that the basis for the calculation of the gross income of the branch in the municipality *is the financial organization itself,* whose gross income has to be distributed, for purposes of paying the gross receipts tax, in proportion to the total deposits obtained by the financial organization. Therefore, *if the financial organization has branches outside Puerto Rico, the income received in Puerto Rico, derived from investments and operations of its capital made in said branches has to be included in said calculation.*

Second, the Municipal Gross Receipts Tax Act of 1974 does contain—in express, clear and precise terms—sufficient language to sustain that a municipality can tax the

income of the banks once they are received in Puerto Rico derived from sources outside the territorial demarcation. Under said law, the authority granted to the municipalities to impose and collect gross receipts tax is *broad* and cannot be given a restrictive interpretation.

From the previously cited Section 2 it appears that the Legislative Assembly expressly estimated as part of the gross income of banks the "income derived from any other sources". In a similar manner, taking into consideration the nature of the banking organization and its operations through branches within and without Puerto Rico, expressly created a formula of proportional distribution, where the volume of business of the banks is determined pursuant to the proportion which the deposits of the branch located in the municipality bear to the total deposits of the financial organization in Puerto Rico. With regard to this, *The Report of the House of Representatives of H.B. 1254*—which subsequently became Act No. 4 of November 14, 1974—established:

> "In a similar manner, the Law is amended to clearly provide that in the cases of commercial banks, savings and loan associations, mutual savings banks, the gross receipts tax to be paid to the municipalities where branches are located should be determined on the basis of the proportion which the *deposits of all kinds in the branches bear to the total deposits of the organization.*" (Emphasis added)

Pursuant to what is stated, it is necessary to conclude that to be able to calculate the total deposits of a banking organization with branches outside Puerto Rico, the income received in Puerto Rico derived from deposits of the branches in the exterior have to be taken into consideration.

With regard to the argument that the contents of the

form "proves that the Secretary of the Treasury interpreted, until the approval of the Regulation, that the Gross Receipts Tax Act only subjected the income from interest generated by loans made on the Island" it should be reiterated that the Secretary of the Treasury can at any time reformulate an administrative rule interpreting a law, when said rule has the effect of correcting or improving a prior one to conform it more adequately to the law and new circumstances. *Licoreria Trigo Inc. v. Sec. of the Treasury*, 94 D.P.R. 270, 281 (1967). Our judicial adjudicative mission does not allow us to establish the law on the basis of forms. The substance of the Law is what is truly important. We ratify the interpretation contained in our Per Curiam decision.

Pursuant to the above and in view of the purpose of the Municipal Gross Receipts Tax Act, the public policy it contains and the terms of our Per Curiam decision, by way of reconsideration it is pertinent that we only modify our mandate in order to remand the case to the lower court so that it, pursuant to Section 34(c) of the Municipal Gross Receipts Tax Act, 21 L.P.R.A. sec. 652 f (c), if necessary, recognize the availability of any credits for those taxes paid by Banco Popular de Puerto Rico in its branches outside Puerto Rico.

ANTONIO S. NEGRON GARCIA
Associate Justice

JUDGMENT

San Juan, Puerto Rico, June 29, 1990.

Pursuant to the grounds stated in the preceding Opinion, which is made to form an integral part of this one, via reconsideration, we modify our Per Curiam Opinion of March 14, 1988 for the sole purpose of remanding the case to the lower court so that it, pursuant to Section 34(c) of the Municipal Gross Receipts Tax Act, 21 L.P.R.A. sec. 652 f (c), and if necessary, will recognize the availability of any credits for those taxes paid by Banco Popular de Puerto Rico in its branches outside Puerto Rico. So modified, it is affirmed.

So pronounced and ordered by the Court and certified by the Acting Chief Clerk. Associate Justice Mister Rebollo López issued a Particular Vote in Conformity. Associate Justice Mister Hernández Denton issued a dissenting Opinion.

Heriberto Pérez Ruiz
Acting Chief Clerk

Dissenting Opinion issued by Associate Justice Mister Hernández Denton (in Reconsideration)

San Juan, Puerto Rico, June 29, 1990

On March 14, 1989 we resolved through a Per Curiam Opinion that the provision of the Regulation of the Municipal Gross Receipts Tax Act which authorized the municipalities to include in the calculation of said tax on the banks the non-exempt income derived from operations carried out outside Puerto Rico, was valid. Banco Popular de Puerto Rico v. Municipality of Mayagüez, 120 D. P. R. _____. By so proceeding, we approved the municipal action of the city of Mayagüez of imposing as of fiscal year 1979-80 a deficiency on Banco Popular and stated that the Municipal Gross Receipts Tax Act contains "sufficient language" to support the thesis that a municipality can tax the income received in Puerto Rico even if derived from sources which derive from outside the territorial demarcation.

Banco Popular requested reconsideration of our determination in a timely manner. In its writ it questions our interpretation of the Gross Receipts Tax Act and states constitutional objections which were not considered by our previous decision.[1]

Since we understand that the Municipal Gross Receipts Tax Act does not authorize the Municipality of Mayagüez to impose said tax on the basis of income generated outside Puerto Rico, and therefore its action was ultra vires, I would reconsider our previous determination, annul the Municipal Gross Receipts Tax Regulation and affirm the judgment of the Superior Court.

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[1] In order to evaluate the merits of the allegations, we granted a term to the municipality of Mayagüez and to the Attorney General to state their position. We also accepted the intervention of Banco de Ponce and the Municipality of Arecibo as *amicus curiae*.

I

Within our constitutional law, municipalities are juridical creatures of the Legislative Assembly. *Colón v. Municipality of Guayama*, 114 D.P.R. 193, 198 (1983). It is the Legislature who has the power to determine everything related to the municipal regime and its functions, Const. P.R., Art. VI, Sec. 1. By their nature, the municipalities do not have power to impose taxes in the absence of a law which authorizes it. *American Express Company v. Municipality of San Juan*, Opinion and Judgment of January 19, 1988, 120 D.P.R. _____.

The Organic Act of the Municipalities, No. 146 of June 18, 1980, authorizes the municipalities to impose a series of taxes. See Arts. 2.04 (24)—(27), 21 L.P.R.A. secs. 2054 (24)—(27). With regard to taxes not imposed over property, the guiding statute authorizes the municipalities to:

> Impose and collect reasonable taxes, duties and excise taxes *within the territorial limits of the municipality* on matters which are not incompatible with taxes imposed by the State. Art. 2.04 (27), 21 L.P.R.A. 2054 (27). (Emphasis added).

On the other hand, the Municipal Gross Receipts Tax Act, No. 113 of July 10, 1974, authorizes the Municipal Assemblies to impose and collect a "gross receipts tax" which, although it adopts the form of a permit or license, it really constitutes a tax or assessment. *American Express, supra.*

Although we have discarded the restrictive interpretative approach to the taxing power of the municipalities with regard to the municipal gross receipts tax,[2] this does

---

[2] Compare *Rubert v. Sancho Bonet, Treas.*, 58 D. P.R. 198, 208-209 (1941) with *American Express, supra*; *Arecibo Bldg. v. Municipality of Arecibo*, 115 D. P. R. 76, 78 (1974) and *Molinos de P. R. v. Municipality of Guaynabo*, 105 D.P.R. 470, 474 (1970).

not mean that the exercise of the power to impose taxes can be carried out without limitations. The scope of the municipal imposition should always have a reasonable basis on the law which authorizes it. See McQuillin, The Law of Municipal Corporations, sec. 44.17 (3rd ed. 1986). In the absence of this support, the claim of the municipal taxing power cannot be sustained.

Moreover, so that a municipality can impose a tax on the gross income derived from sources outside its territory, it is indispensable that the Legislature delegate that authority in an express, clear and precise manner. *Banco Popular v. Municipality of Mayagüez*, 120 D. P.R. ____ (1988). Opinion of May 14, 1988. *Present legislation does not contain—in express clear and precise terms—sufficient language to "support the thesis that a municipality can tax the income of the banks once they are received in Puerto Rico, even if derived from sources outside the territorial demarcation." Id.* Let us see.

III

Through the Municipal Gross Receipts Tax Act of 1974, the Legislative Assembly delegated on the municipalities the authority to impose and collect the gross receipts tax from "all persons engaged for profit purposes in rendering any service, in the sale of any goods, to any financial business or to any industry or business *in the municipalities of the Commonwealth of Puerto Rico,* except (for) what in another sense is provided in Secs. 651 to 652 and of this title.", Sec. 4, Municipal Gross Receipts Tax Act, 21 L.P.R.A. Sec. 651c. See also Sec. 3, 21 L.P.R.A. Sec. 651b.

In general, the gross receipts tax is a maximum tax of 1% in the case of financial businesses and 0.3% for all other cases, computed on the basis of the "volume of business" of the entity subject to the tax. Sec. 5, 21 L.P.R.A. 651d. As a general rule, volume of business:

> means the gross income that is received or derived by rendering any service, from the sale of any goods or from any other industry or business *in the municipality where the main office carries out its operations* or the gross income that is received or derived by the main office *in the municipality where it maintains* offices, warehouses, branches, manufacturing, container, bottling, processing, preparation, confection, assembly extraction plants, place of construction or any other kind of business or industrial organization to conduct business in its name without considering its profits or earnings. Sec. 2(a)6(A), 21 L.P.R.A. sec. 651a(a)(6)(A). (Emphasis added).

Notwithstanding this, when dealing with a financial business, the Municipal Gross Receipts Tax Act defines volume of business as:

> the gross income received or earned, excluding:
>
> (1) the cost of the property sold;
>
> (2) the reimbursement of advances, loans and credits granted, but without the amount deducted exceeding the principal of said advances, loans or credits;
>
> (3) the deposits; and
>
> (4) the losses incurred in any operation on securities, but without the deduction exceeding the total earnings obtained for said securities.

In the specific case of commercial banks and savings and loan associations, mutual savings banks, gross income will mean the interest received or earned from loans, the service charges, revenues, the gross profit in the sale of property or securities and *the profits, earnings and income derived from any other source.*

> The gross income earned by these organizations subject to the payment of the gross receipts tax will be distributed among the branches pursuant to the proportion all the kinds of deposits of the branch bear to the total deposits of the organization. Sec. 2(a)(6)(B), 21 L.P.R.A. sec 651a(6)(B). (Emphasis added).

The gross receipts tax, since it was instituted for the first time in 1914, was contemplated as a tax on income derived from operations located in Puerto Rico. The legislation prior to the present statute on gross receipts tax, Act No. 26 of March 28, 1914, in its Sec. 4 defined volume of business as:

> . . . the gross income in *any municipality* of a business or industry derived from the operations it carries out in Puerto Rico, without taking into account its profits or earnings; that is, since we are dealing with banks or private banks, the total amount of the loans made every year, when the term of said loans is one year or more or the proportional part of same corresponding to their different terms if made for less than one year, and the total amount of its business in commissions, excepting the sale and change of money orders or checks; the total amount of the sales, when dealing with stores, business concerns or other industries; the total amount of the value of the freight and tickets in every office established in each municipality, when dealing with vehicles for ground transportation; the total amount of its sales, when dealing with commission agents or brokers; the total amount of what is collected for telephone or electrical services, when dealing with companies of this kind, and in general the total amount of income obtained for any business carried out or service rendered,

> pursuant to the nature of the business or the industry established. (Emphasis added).

While the law had this language it was interpreted by the Secretary of Justice to include only the income derived from operations located in Puerto Rico. Op. Sec. Just. 1959-16; Op. Sec. Just. 1960-78.

The aforementioned provision was amended by Sec. 4 of Act No. 93 of June 25, 1962. The express reference to "operations (carried out) in Puerto Rico" was suppressed and a general definition of volume of business very similar to the one provided by Sec. 2(a)(6) of the present Municipal Gross Receipts Tax Act was adopted:

> Volume of business will be understood to mean for purposes of this law, the gross income obtained from a business or industry *in the municipality where the main office conducts operations,* or the gross income obtained by the main office *in the municipality where it maintains* a sales office, warehouse, or any kind of commercial or industrial organization to conduct business on its behalf, without taking into account its profits or earnings; . . . [Emphasis added].

The amendment occurred shortly after the interpretation we gave to the cited Sec. 14 in the case *The Shell Co. P. R. v. Government of the Capital,* 82 D.P.R. 39 (1960). There we held that when dealing with a wholesale establishment, with its principal office established in a specific municipality, but doing business in the entire island, the gross receipts tax should be imposed by the municipality where the main office is located, regardless of where the branches are located. *15 Diary of Sessions 1683 (1962).* The Legislative Assembly modified Sec. 4 of the Law because it understood:

> that it was not a good public policy to empower some municipalities to impose gross receipts taxes on specific companies for the volume of business made outside the territorial demarcation of the municipality in question, if as a result of this other municipalities would be deprived of the power of imposing gross receipts taxes on the volume of business made [sic] by said company within the territorial limits itself corresponding to said other municipalities . . . [W]hat is fair and equitable is that each municipality have access, for purposes of imposing the gross receipts tax that are required, exclusively to the volume of business carried out within their own geographical area. Id.

It was not intended that this amendment have the purpose of eliminating the limitation that the income must derive from operations carried out in Puerto Rico.

Even though the Municipal Gross Receipts Tax Act of 1974 expanded the number of industries or businesses covered, there is nothing in the law nor in its legislative history to allow a reasonable inference that the legislative intent was to tax income from sources outside Puerto Rico.

This is corroborated by the administrative practice itself of the municipalities and of the Department of the Treasury since the approval of the Law. From the tax return or form prepared by the Department of the Treasury itself and circulated to the municipalities to be filled out by taxpayers in their statements of volume of business, it appears that the interpretation of the Gross Receipts Tax Act made by the Secretary of the Treasury coincided with the cited opinions of the Secretary of Justice. Page 2 of Form No. 73 contains several boxes to calculate and determine the volume of business of different organizations.[3]

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[3] We have included as an appendix a copy of form model 73 (revised

Box 3 corresponds to commercial banks, savings and loan associations, and mutual savings banks.

An examination of the different items in box 3 reveals that with regard to interest income, item No. 4 lists for inclusion only the "Interest Received or Earned from Loans *Granted in Puerto Rico*". (Emphasis added). Item No. 15 that is used to calculate the formula of proportional attribution on the basis of the deposits in branches of the municipality only includes the "Total Deposits of the *Organization in Puerto Rico*". (Emphasis added). This proves that the Secretary of the Treasury interpreted, until the approval of the Regulation, that the Gross Receipts Tax Act only subjected income from interest generated by loans granted on the Island.

But, despite this administrative practice, on September 28, 1982 the Municipality of Mayaguez notified Banco Popular a deficiency for not having included in the gross income the income derived from investments and operations of its capital made in its branches outside Puerto Rico.

Banco Popular questioned the deficiency that had been notified to it in a timely manner. While its request for reconsideration was being considered, the Secretary of the Treasury enacted on August 10, 1984 the present Regulation which amended the general definition of gross income, to include income received from sources outside Puerto Rico, specifically:

> all of the income from sources within or without Puerto Rico that is received or earned in the operation that is carried out in each municipality, including all the additional income such as interest and dividends attributable to the operation. Art. 2(7)(A) Regulation 3142. (Emphasis added)

---

in March 1980) which was used by the appellee bank to fill out the declaration of volume of business for the year 1982.

The Regulation did not substantially modify the definition of "volume of business" for purposes of a financial business, but by attending to the specific case of commercial banks, mutual savings banks and savings and loan associations, it radically changed the rules of the game established since 1974 and incorporated a language incompatible with the Municipal Gross Receipts Tax Act.

> Banks—In the specific case of commercial banks, savings and loan associations and mutual savings banks, gross income will mean the interest received or earned from loans, service charges, revenues, gross profit in the sale or properties or securities, *and the profits, earnings and income derived from any other source within or without Puerto Rico attributable to the operation in Puerto Rico.* Provided that the interest on debentures of the Commonwealth of Puerto Rico, its instrumentalities and municipalities, as well as the debentures of the United States will not be included as gross income.
>
> Gross income earned by these organizations subject to the payment of gross receipts tax will be distributed among the branches pursuant to the proportion that all kinds of deposits of the branch bear to the total deposits of the organization. Art. 2(7)(B) Regulation 3142. (Emphasis added).

This regulation became effective on September 21, 1984 and is not applicable to income derived outside Puerto Rico received by banks before that date. However, the regulation supports the thesis invoked by the Municipality of Mayagüez in the controversy before us. Although pursuant to strict law, the Regulation is not applicable to the deficiencies notified in the case at bar, its validity also depends on the fact that the Municipal Gross Receipts Tax Act grants the municipalities the power to impose gross

receipts taxes on the type of income that originates this controversy. For the reasons stated in this opinion, it is evident that the Regulation is also ultra vires and cannot be used to impose this type of gross receipts tax after its effective date. However, did the Municipal Treasurer as well as the Secretary of the Treasury have authority pursuant to law to expand the scope of the municipal taxation and tax the income derived from sources outside Puerto Rico with the imposition of a gross receipts tax? I believe they didn't.

IV

Our prior decision based the authority of the Municipality of Mayagüez to tax the income derived from outside Puerto Rico with a gross receipts tax on the second paragraph of Sec. 2(a)(6)(B) of the Gross Receipts Tax Act, specifically the final phrase. This provision determines "gross income" subject to the gross receipts tax in the specific case of banks. As a definition of the term, the law lists several items of income and concludes with the phrase: "and the profits, earnings and income derived from any other source". We held that "source" meant "origin" and therefore in the case of banks, the municipal treasurer had the power to calculate the gross receipts tax on the basis of all the income from sources within or without Puerto Rico received or earned from the operation in each municipality. Examining again the original appearance of the parties and the briefs submitted in reconsideration, we are convinced that we should reconsider our prior interpretation as to the scope of this clause.

In the first place, in *correct juridical hermeneutics* the phrase ". . . and the profits, earnings and income derived from any other source", cannot be interpreted in the geographical sense as attempted through the regulation. When in a law the words having a general meaning follow specific words in a descriptive enumeration, the general words should be interpreted to include only similar objects in

their nature to the ones listed by the preceding specific terms. Bernier and Cuevas Segarra, *Aprobación e interpretación de las Leyes en Puerto Rico* 341 (1987). This doctrine of statutory construction is known as ejusdem generis ("from the Latin of the same gender or species") or the Rule of Lord Tenderson. Id. The rule "/i/ntends to reconcile incompatibility between general and specific words pursuant to other rules of legal hermeneutics, such as that effect has to be given to all the words of the statute and that the Legislative Assembly does not use superfluous words." Id.

The doctrine applies in the following circumstances:

> (1) the statute contains a list by specific words;
>
> (2) the members of the list constitute a class;
>
> (3) the list does not cover the entire class;
>
> (4) a general term follows the enumeration; and
>
> (5) the intention that the general term be given a broader meaning than that required by the doctrine is not clearly manifest. *Puerto Rico Ilustrado v. Buscaglia,* Tes. 64 D. P. R. 914, 922 (1945).

In this case the second paragraph of Sec. 2(a)(6)(B) of the Municipal Gross Receipts Tax Act lists through specific words what gross income means when dealing with financial businesses of a banking nature, to wit: "interest received or earned from loans, charges for services rendered, revenues [and] the gross profit in the sale of properties or securities. . ." There also exists a common denominator of this entire enumeration which consists in belonging to items or types of income. The enumeration does not exhaust the gender since there are other types of income not covered by the ones stated. On the other hand, there is a general phrase after the enumeration, to wit: "and

the profits, earnings and income derived from any other source."

The fifth requirement is vital, since "[t]he entire science on ejusdem generis lacks meaning if the statute contains the clear manifestation of a contrary intention." *Puerto Rico Ilustrado, supra,* page 925. After all, the doctrine of ejusdem generis "is only an aid" Id. One cannot rely on a maxim of interpretation if the true legislative intent has been another. *Autoridad sobre Hogares v. Superior Court,* 82 D.P.R. 344, 359 (1961).

After a careful examination of the entire Municipal Gross Receipts Tax Act, we have not been able to identify any provision—aside from the one that is in controversy herein—that grants municipalities the express or implicit power to impose the gross receipts tax on income derived outside Puerto Rico because they are received here. In fact, *not even in the Gross Receipts Tax Act nor in its history was this income mentioned. We should not use the "crystal ball" to guess the legislative "mens" and ratify an incorrect and unconstitutional judicial action.* From the above analysis the conclusion is evident that in this case all the requirements of the doctrine of ejusdem generis are complied with and the actions of the Municipality and the Department of the Treasury should be annulled.

On the other hand, the term "source", used in a general manner in Sec. 2(a)(6)(B) of the Gross Receipts Tax Act has several meanings. Even in the same context, the word can be interpreted in several senses. In what is pertinent herein, it can be defined as "origin, source from which a thing is born or derived", Diccionario de la Real Academia Española 1068 (Ed. 20 1984). Although there is no doubt that the word can have a geographical meaning, from the application of the rule of ejusdem generis this interpretation cannot be sustained. Since the specific enumeration of Sec. 2(a)(6)(B) encompasses types or kinds of income, "origin" refers also to this gender; therefore, in the stat-

ute said term means "item, category or classification". In the context used in the Municipal Gross Receipts Tax Act "the origin or source" of an income is the *particular* operation which produces it and not *the place* from which it is derived.

In second place, when applying the rule of contextual interpretation established in Art. 17 of the Civil Code, 31 L.P.R.A. Sec. 17, the geographical sense must be rejected in the same manner. Note that in the statute the word "origin" is not used in the definition of volume of business for financial businesses which are not banks[4] nor in the general definition.[5] The term is only used to define the gross income that is considered part of the bank's volume of business. The reason is evident. In the calculation of the gross receipts tax, the Law treats banking businesses in a manner different to that of the rest of financial businesses.

According to Sec. 6 of the Law, any person engaged in businesses or industries subject to the application of different rates, will pay the gross receipts tax prescribed for each industry or business separately. 21 L.P.R.A. Sec. 651e. That is, the Law allows the segmentation of the volume of business to exclude certain classes or types of income from the tax at the maximum rate of 1%. *Cf. American Express, supra. However, in the case of banks what the second paragraph of Sec. 2(a)(6)(B) intends is to qualify this rule by determining, through the language in controversy, that the tax basis will be calculated without the benefit of the segmentation of the volume of business.*

The legislative technique used to achieve this result was to define the gross income of banks subject to the gross receipts tax with an enumeration listing the different types of income (interest, service charges, revenues, profits on

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[4] See first paragraph Sec. 2(a)(6)(B).

[5] See Sec. 2(a)(6)(A).

the sale of properties and securities) followed by the phrase "and the profits, earnings and income derived from any other source". Within the context of the Law, the best interpretation of the final phrase of the second paragraph is that it was used by the Legislator to mean any other kind or type of income or activity but always within the scope of the general definition of gross income of Sec. 2(a)(6)(A) of the Law. To attribute a geographical sense to it is to unreasonably expand the legislative intent with questionable support in the text of the law and create—with no justification—an arbitrary discrimination against Puerto Rican banks who have branches outside the Island. This very limited group of taxpayers would be the only ones that would be subject to the gross receipts tax on income derived from sources outside Puerto Rico,[6] which situation would require an analysis of the constitutionality of this classification pursuant to the doctrine of equal protection of the laws. *Marina Ind. Inc. v. Brown Bovery Corp.*, 114 D.P.R. 64, 81-83 (1983).

V

Without prejudging the merits of the constitutional claims, it is convenient to make some expressions on the position of the majority with regard to the application of the commerce clause to the facts of this case.

Intervenor Banco de Ponce states that if the municipalities of the Island subject to the payment of the gross receipts tax the general income of the banks outside Puerto

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[6] Although the general definition of gross income in Regulation 3142 includes those derived from sources within or without Puerto Rico, the interpretation of the term origin which a majority of the Court today supports only authorizes the imposition of gross receipts taxes on the basis of income originating outside the jurisdiction in the specific case of banks. Our prior pronouncement did not approve said tax for other businesses, since in the latter case it would clearly not be supported by the law.

Rico without granting any credit for the taxes paid outside Puerto Rico, "this would cause an assumption of multiple taxation", in violation to the commerce clause of the United States. The opinion issued by the Court considers that "this is the argument with the greatest persuasive force", but rejects it after interpreting that the case of *Tyler Pipe Industries Inc. v. Washington Dept. of Revenue,* 483 U.S. 232 (1987),[7] is limited only to situations where the statute is discriminatory on its face.

However, the opinion does not correctly interpret the most recent expression of the U.S. Supreme Court in *Goldberg v. Sweet,* 102 L.Ed.2d. 607 (1989) on the constitutionality of a tax of the State of Illinois on interstate telephone calls. The tax there was not discriminatory on its face. In fact, the court held that it did not discriminate against interstate commerce. Id. at pages 618-622. In holding that the Illinois tax was constitutional, the Court clarified that the requirement of the commerce clause that the tax be fairly apportioned was determined through an examination of the tax to see if it was "internally and externally consistent", Id. at page 616.

The criteria of internal consistency requires that the tax "be structured thus that if each state were to impose an identical tax, it would not result in double taxation." Id. (translation ours). The proof of external consistency consists in determining "if the State has imposed the tax only on that portion of the income derived from interstate commerce which reasonably reflects the in-state component of the activity taxed." Id. (translation ours).

Under the criteria of internal consistency, it is not necessary that the taxpayer prove the existence of a tax on

---

[7] In this decision the Supreme Court of the United States held that to prove the risk of multiple taxation a taxpayer did not have to affirmatively prove that some other state imposed on it a tax over the same income derived from interstate commerce.

the same income. It merely contemplates the hypothetical situation that other states have approved an identical statute, id, and it is examined if, under this assumption, multiple taxation would exist.

On the other hand, the majority, aware of the constitutional implications of its decision and *without having absolutely any basis in law, "creates" a credit* to avoid double taxation to prevent Banco Popular from invoking its rights pursuant to the U. S. Constitution. In so doing it violates the elementary principle of tax law that deductions, exemptions and credits, because they are legislative graces to the taxpayer, are restrictively interpreted against them. See *Central Igualdad v. Sry. of the Treasury*, 83 D.P.R. 45, 50 (1961); *Descartes, Treas. v. Tax Court and Ortiz*, 73 D.P.R. 491, 497 (1962) and sources therein cited. The majority opinion has gone beyond this standard, since it does not expand a credit provided by the law but rather "legislates judicially" to institute a new credit that had not been contemplated in the scheme of the Municipal Gross Receipts Tax Act.

To further complicate the problem created by the Per Curiam Opinion and the pronouncements issued in reconsideration, the case is remanded to the lower court without some clear directives to give the appellee bank the opportunity to demonstrate the multiple taxation, which action we have already seen is erroneous, and so that the court can recognize "the origin of any credits for those taxes paid in the branches outside Puerto Rico". (Emphasis added). What type of tax has to be imposed and paid in other jurisdictions in order to grant the credit?

For these reasons, what is proper in reconsideration is that we reverse our previous determination and affir the judgment of the Superior Court. Even though there is an intrinsic value in the certainty, speed and consistency of the decisional process of this institution, the timely rec-

tification of an erroneous decision is always an exemplary initiative in our contemporary society.

FEDERICO HERNANEZ DENTON
Associate Justice

Particular Vote of Conformity issued by Associate Justice Mister Rebollo Lopez

San Juan, Puerto Rico, June 29, 1990.

We are pleased that the Court, through the majority Opinion which in reconsideration was issued today, has decided to correct the errors which it incurred in issuing the Per Curiam Opinion of March 14, 1988, which errors forced us to dissent on that occasion.

In jurisprudentially establishing the mechanism—via a credit—which will avoid incurring in the unconstitutional practice of double taxation and in clarifying that the income subject to tax by the banking institutions, derived from investments and operations of their branches located outside Puerto Rico, are those received by it in Puerto Rico, the majority Opinion issued corrects the objections of the solitary dissent which we stated on that previous occasion.

FRANCISCO REBOLLO LOPEZ
Associate Justice

1982 **COMMONWEALTH OF PUERTO RICO** 1983
MAYAGUEZ
Municipality

STATEMENT ON VOLUME OF BUSINESS
FOR THE NATURAL YEAR 19____
OR OTHER TAX YEAR COMMENCING ON
_____19____ AND ENDING ON _____ 19____

Name of industry, business or service office	Social Security Account No.
Banco Popular de Puerto Rico	66-017-5278

Address
See Addendum II

Class of Industry, Business or Service	Date on which business was established
Commercial Bank	October 1893

Name of Owner or Representative	Did you file a Statement of Volume of Business for the previous year?
Tere Loubriel, Senior Vice President and Comptroller	yes x no _____

Postal Address	Zip Code
G.P.O.Box 2708, San Juan, Puerto Rico	00936

Residential Address	Zip Code
G.P.O.Box 2708, San Juan, Puerto Rico	00936

Address of principal place of Business, Industry or Service Office	Zip Code
G.P.O.Box 2708, San Juan, Puerto Rico	00936

BOX 1

Determination of Gross Receipts Tax to be Paid

1. Volume of Business from Accounting Year immediately prior to Present year (from, Box 2, 3, or 4, as applicable) Page 2	$2,627.119
2. Type of Gross Receipts Tax established by Municipal Assembly	1%
3. Gross Receipts Tax to be Paid (Multiply Item 1 by item 2 and write product here) $ 26,271	

* In case of financial businesses, the volume of business will be equal to the Adjusted Gross Income.

CERTIFICATION

I CERTIFY that the volume of business herein declared is true and correct and that the Balance Sheet and Profit and Loss Statement that is enclosed correctly reflects the financial situation of this Business as of December 31, 1981.

3-11-82	sgd. Tere Loubriel
Date	Signature of person subject to the Payment of Gross Receipts Tax or Authorized Agent

OATH

I, Tere Loubriel, owner or authorized representative of the above stated business, state under penalty of perjury

that what is stated herein is true and personally known to me.

3-11-82	sgd. Tere Loubriel
Date	Signature of person subject to the Payment of Gross Receipts Tax or Authorized Agent

Aff. 12, 573

Sworn and subscribed to before me by Tere Loubriel of legal age, Senior Vice President and Comptroller, and resident of San Juan, Puerto Rico on March 11, 1982.

Notary Public	Notary signature illegible
Title	Signature of (illegible)

DETERMINATION OF VOLUME OF BUSINESS

BOX 2

Commerce or Industry
Services or Combined

1. Gross income for the accounting year immediately preceding the present one $
2. Less: Sales Returns
3. Adjusted Gross Income (transfer to item 1, Box 2 of page 1) $

BOX 3
Commercial Banks, Savings and Loans Associations, Mutual Savings Banks
Local Operations of Organization

(TO BE FILLED OUT BY MAIN OFFICE)

4. Interest received or earned on loans granted in Puerto Rico $
5. Service Charges $

6. Revenues	$	
7. Gross Income on the Sale of Securities	$	
8. Gross Income on the Sale of Property	$	
9. Less Cost of Property Sold	$	
10. Adjusted Gross Income on Sale of Properties	$	
11. Other Income Received	$	
12. Gross Income for Tax Year immediately preceding present one		$
13. Less:		
a. Reimbursement of advances, loans and credits granted (Should not exceed principal of same)	$	
b. Deposits	$	
c. Loss in operations on securities (should not exceed total of earnings obtained from same)	$	
14. Total Gross Adjusted Income of Organization (See Appendix I)		$147,706.657

Branches and/or Main Office

15. Total deposits of Organization in Puerto Rico (same as item 13b)	$1,987,737
16. Total deposits of branches in this Municipality	$ 35,354

17. Proportion total deposits of the branches bears to total deposits of the organization (Divide item 16 between item 15 and write result here		1.778606
18. Adjusted Gross Income of Branch or Main Office in this Municipality (Multiply item 14 by item 17) Transfer to item 1, Box 1 of page 1		$ 2,627,119

BOX 4
Other Financial Businesses

19. Gross Income for Accounting year immediately preceding present year		$
20. Less:		
a. Cost of Property Sold	$	
b. Reimbursement of Advances, Loans and Credits Granted (Should not exceed the principal of same)	$	
c. Loss in operations on securities (should not exceed the total earnings obtained for same)	$	
21. Adjusted Gross Income (transfer to item 1, Box 1 of page 1	$	

APPENDIX C

AT THE SUPREME COURT OF PUERTO RICO

RE: 87-19

BANCO POPULAR DE PUERTO RICO
Plaintiff-Appellee

v.

MUNICIPALITY OF MAYAGUEZ
Defendant-Appellant

ON WRIT OF REVIEW

ORDER

San Juan, Puerto Rico, June 28, 1991.

As to the second motion to reconsider filed in this case: Denied and heed the mandate.

As agreed by the Court and certified by the Acting Chief Clerk. Chief Justice Pons-Núñez issued a particular vote to express that he agrees with this Order. Associate Justice Hernández-Denton would reconsider.

(Sgd.) Heriberto Pérez-Ruiz
Acting Chief Clerk

Supreme Court, U.S.
FILED
JAN 8 1992
OFFICE OF THE CLERK

(2)

No. 91-521

In The

Supreme Court of the United States

October Term 1991

BANCO POPULAR DE PUERTO RICO,

Petitioner,

v.

MUNICIPALITY OF MAYAGUEZ,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of Puerto Rico

RESPONDENT'S BRIEF IN OPPOSITION

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January 8, 1992

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No. 91-521

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BANCO POPULAR DE PUERTO RICO,

Petitioner,

v.

MUNICIPALITY OF MAYAGUEZ,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of Puerto Rico

RESPONDENT'S BRIEF IN OPPOSITION

Respondent Municipality of Mayaguez respectfully requests that this Court deny the petition for a writ of certiorari seeking review of two judgments of the Supreme Court of the Commonwealth of Puerto Rico. The first judgement was issued on March 14, 1988 and is unofficially reported as *Banco Popular de Puerto Rico v. Municipality of Mayaguez*, P.R. Bar Ass'n. Adv. Sh. 1988-26; 88 JTS 29; the other one, on rehearing was issued on June 29, 1990, bears the same caption and is unofficially reported as P.R. Bar Ass'n. Adv. Sh. 1990-88; 90 JTS 99.

STATEMENT OF THE CASE

I. The Statutory Framework

The Municipality of Mayaguez is a political and juridical entity with full legislative and administrative powers in any matter of municipal nature. 21 L.P.R.A. 2051. As may be prescribed by the Legislature of the Commonwealth of Puerto Rico, a municipality may impose Income Taxes and License Fees for the purposes of the municipal government. Act of Congress of March 2, 1917 (Jones Act), c. 145, Section 3, 39 Stat. 953 and Act of Congress of April 12, 1900 (Foraker Act), c. 191, Section 38, 31 Stat. 86.

The Legislature of the Commonwealth of Puerto Rico enacted in 1974 the present Municipal License Tax Act, 21 L.P.R.A. Secs. 651-652y, which authorizes all municipalities to collect municipal license taxes from every person engaged for profit in the rendering of any service, in the sale of goods, in any financial business or in any industry or business in the municipalities of the Commonwealth of Puerto Rico. 21 L.P.R.A. 651c.

The Municipal License Tax Act imposes its revenue tax on a commercial bank's "volume of business" which is defined as:

> "(B) Financial business. – Where financial business is involved, the volume of business shall be the gross income received or earned, excluding:
>
> > "(1) reimbursement of advances, loans and credits granted, but the sum deducted on this account shall not exceed the principal of said advances, loans or credits;
> >
> > "(2) the deposits; and

> "(3) losses incurred in any operation in securities, but the deduction made on that account shall not exceed the total amount of the profits obtained for said securities.
>
> "In the specific case of commercial banks and savings and loan associations, mutual or savings banks, the gross income shall mean the interest received or earned on loans, the fees for services rendered, the rents, the gross benefit in the sale of property or securities and the profits, benefits and income derived from any other source.
>
> "The gross income earned by these organizations subject to payment of licenses shall be distributed among the branches in accordance with the proportion of all kinds of deposits of the branch with the total deposits of the organization." 21 L.P.R.A. 651a(a)(6)(B).[1]

On August 24, 1984, the Secretary of the Treasury of the Commonwealth of Puerto Rico, under the authority granted to him by the Municipal License Tax Act prescribed and filed Regulation No. 3142, the "Municipal License Tax Regulation" (hereinafter referred to as "Regulation No. 3142").

To the definition of a Bank's Volume of Business provided in Section 651a(a)(6)(B) (cited above), Article 2(7)(B) of Regulation No. 3142 adds the words we have italicized below as quoted from this Article:

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[1] The municipalities in Puerto Rico have been authorized by the Puerto Rico Legislature to impose Municipal License Taxes since 1914. The apportionment rules herein established for banks was an amendment to the present 1974 Act.

"Banks –

"In the specific case of commercial banks and savings and loan associations, mutual or savings banks, the gross income shall mean the interest received or earned on loans, the fees for services rendered, the rents, the gross benefit in the sale of property or securities and the profits, benefits and income derived from any other source *within or outside of Puerto Rico, attributable to the operation in Puerto Rico. Provided, however, interest on the obligations of the Commonwealth of Puerto Rico, its instrumentalities and municipalities as well as the obligations of the United States shall not be included as gross income.*

"The gross income derived by all financial organizations subject to the payment of the municipal license tax shall be distributed among the individual branches based on the deposits of such branches as a proportion of the total deposits of the organization."

II. Framework of the Dispute

Respondent Banco Popular de Puerto Rico is a Bank organized under the Laws of the Commonwealth of Puerto Rico and has its principal corporate office in San Juan, Puerto Rico. In addition to the banking branches it has established in almost all the municipalities in our Island, Banco Popular de Puerto Rico has branches in California, New York and the U.S. Virgin Islands.

In 1980 the Municipality of Mayaguez issued a Notice of Deficiency for the payment of Municipal License Tax as provided by 21 L.P.R.A., Section 651o of the Municipal License Tax Act. Respondent alleged that Petitioner had

excluded from its volume of business computations in its municipal license tax returns the following items:

(a) Income derived from Investments outside Puerto Rico.[2]

Interest due from foreign banks time	$120,568,129
Securities discount accretion of foreign securities	1,333,439
Interest foreign securities under resale	1,883,590
Interest of foreign banks acceptances	206,628
Interest other foreign securities or investments	29,066,000
	$153,057,786

b) Gross Income derived from bank branches outside Puerto Rico.

California, St. Croix and New York branches income	$15,950,283

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[2] These numbers, as obtained from the Puerto Rico Franchise Tax Return, were stipulated in the Trial Court and pertain to only one tax year (1982) of the controversy. The reference to foreign banks includes U.S. Banks.

(c) Interest Income from obligations of the U.S. Federal and Puerto Rico Government and their Instrumentalities and Municipalities[3]

$62,776,703

In the Per Curiams, the Supreme Court sustained the tax deficiency imposed by the Municipality and clearly stated that the computation of volume of business is based on the following formula:

Deposits of the Bank in the Municipality of Mayaguez	X	Gross Income	=	Volume of Business
Total deposits of the Bank		from all sources		subject to Municipal Tax in Mayaguez

In the second opinion, the Supreme Court of Puerto Rico ratified the interpretation contained in the first Per Curiam opinion and ordered the computation of any excess tax credits which could have been paid to any jurisdiction outside of Puerto Rico. This second opinion reaffirmed the above stated formula with no other possible interpretation.

[3] Both the Trial Court and the Commonwealth of Puerto Rico Supreme Court held that this income was free from municipal license taxation. This ruling is not at issue herein.

REASONS FOR DENYING THE PETITION

As Regards the First Question Presented in the Petition:

I. THE COURT NEED NOT REVIEW THIS QUESTION BECAUSE THE SUPREME COURT OF THE COMMONWEALTH OF PUERTO RICO'S DECISION IS NOT IN DIRECT CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

The decision of the Puerto Rico Supreme Court is not in direct conflict with applicable decisions of this court and the Petitioner has not demonstrated the contrary.

Petitioner's contention is based on the allegation that the Municipal License Tax as imposed on Petitioner violates the four-pronged test for determining the validity of a state tax under the Commerce Clause as applied in the decision of *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977). Specifically, Petitioner alleges that the tax is not internally consistent. This test requires that "to be internally consistent, the tax must be structured so that if every state were to impose an identical tax, no multiple taxation would result."

In its request for a writ of certiorari, Petitioner, who has the burden of proof, fails to substantiate its position. The Petitioner's first question presented for review is, essentially, based upon the following three allegations:

(a) Petitioner alleges that the Municipal License Tax Act and the Per Curiam opinions of the Supreme Court of Puerto Rico are not clear because they lack guidelines

and definitions in relation to foreign source income.

Contrary to this allegation, the guidelines are very clear. We have outlined in the statement of facts the formula of the last paragraph of 21 L.P.R.A. 651 a (a)(6)(B) which specifically governs the apportionment of a bank's income. The Puerto Rico Supreme Court reaffirmed that the income from all sources within and without Puerto Rico is includable in the computation.[4] The formula is a clear guideline that simply requires a mathematical computation of including all income and apportioning it according to the deposits in each branch.

As a basis for the lack of guidelines in the Municipal License Tax Act, Petitioner cites *Sea-Land Services, Inc v. Municipality of San Juan*, 505 F Supp 523 (1980). This case is totally immaterial to the present circumstances since there is clearly no apportionment guideline in the Municipal License Tax Act for the shipping industry whereas there is one for the banking industry.

(b) Petitioner alleges that even if the apportionment formula of the last paragraph of 21 L.P.R.A. 651a(a)(6)(B) were to be construed as interpreted by the Supreme Court of Puerto Rico, it would still present the question as to whether the tax was fairly apportioned.

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[4] Up to the year 1962 the prior Municipal License Tax Acts required that the Volume of Business income subject to the tax be from the operations conducted in Puerto Rico. The limitation of Puerto Rico source income was deleted by legislation.

The only argument used by Petitioner to sustain this allegation is that each municipality in the Commonwealth of Puerto Rico could interpret the "attributable" income in a different light as to create confusion and inconsistent application of the apportionment formula. We assume that the Petitioner's contention is that this would subject the bank to multiple taxation in violation of the Commerce clause. We disagree. The Puerto Rico Supreme Court avoided the issue of defining what is attributable, because it was not necessary. The formula distributes the income among all the branches within and without Puerto Rico and the income, as computed, is attributed to the respective municipalities. In *Trinova Corporation v. Michigan Department of Treasury* , 498 U.S. ___, 112 L. Ed. 2d 884, 904, 111 S. Ct. ___ (1991) this court affirmed "We seek to avoid formalism and to rely upon a 'consistent and rational method of inquiry [focusing on] the practical effect of a challenged tax.' *Mobile Oil Corp. v. Commissioner of Taxes of Vt.* 445 US 425, 443, 63 L Ed 2d 510, 100 S Ct 1223 (1980)."

The Petitioner, in effect, raises the issue of fairness providing no proof of the unreasonableness of the apportionment formula as applied to the bank. To prove internal inconsistency the obvious component of unfairness has to be proven. Also, in the petition, there is not one allegation on how the Petitioner could be subject to multiple taxation in other states.

In fact, the apportionment formula is not specifically contested as being unfair. Banco Popular de Puerto Rico is a corporation organized under the provisions of the Banking Law of the Commonwealth of Puerto Rico, 7 L.P.R.A. 1 et seq., and duly registered as a domestic

corporation under the provisions of the General Corporation Law of the Commonwealth of Puerto Rico, 14 L.P.R.A. 1 et seq. Its principal offices and central management are in San Juan, Puerto Rico. The direction of all active and passive investment is located in San Juan. The bank is one unit engaged in the same business. The principal matter in this case concerns the foregoing source of passive income obtained from the investment of the excess funds of all the branches of the bank. These excess funds are managed by the principal office and the income generated is not limited to a specific branch.

The legislature of the Commonwealth of Puerto Rico provided an apportionment formula as a necessary element of fairness in taxation. The tax is not geared to allocating all of the bank's out-of-state income to Puerto Rico or to a particular municipality. Instead, it is structured in the context of dividing the tax base by apportionment. If no formula had been enacted, each branch would have only the income from the services it provided. The excess passive income would all be received by the principal office in San Juan in detriment of the local and exterior branches that generated the deposits. The formula was devised and is premised on fair and equitable grounds because it directs distribution of all income among all the branches.

This Court has consistently ruled that the Constitution imposes no single formula on states imposing a tax. The apportionment measure of the *Complete Auto Transit, Inc. v. Brady* case cited by Petitioner is but one of the formulas utilized by this Court. See e.g. *Moorman Manufacturing Company v. Bair*, 437 U.S. 267 (1978). The critical point which has been complied with by our statute is that

the gross receipt tax levied upon the interstate activity reflects the portion of the bank's activity that is conducted within the Commonwealth of Puerto Rico.

(c) Petitioner alleges that the Supreme Court of Puerto Rico conceded for all practical purposes that the Municipal License Tax Act was unconstitutional as it pertains to non Puerto Rico source income of the bank and attempted to save the statute by fashioning a "remedy" for the tax.

The apportionment formula of our Municipal License Act is fair and does not require a tax credit provision for it to be constitutional. In any event our Supreme Court did interpret that such credit for taxes paid is available in our Municipal License Tax Law. This leads to the second issue presented for review.

As Regards the Second Question Presented In The Petition:

II. RATHER THAN A CONTRIVANCE TO DEFEAT REVIEW BY THIS COURT, THE PUERTO RICO SUPREME COURT'S RECOGNITION OF THE CREDIT IS A VALID EXERCISE OF JUDICIAL INTERPRETATION.

As a second issue presented for review, the Petitioner asserts that the decision of the Supreme Court of Puerto Rico does not rest on adequate and independent state ground, essentially on the allegation that the Puerto Rico Supreme Court's recognition of a credit against the municipal license tax is "merely a contrivance to try to defeat this court's review of the validity of the tax at

issue." The Petitioner's allegation is totally unreasonable and without substance.

Rather than a contrivance or device to defeat this Court's jurisdiction, the Puerto Rico Supreme Court's decision represents a valid exercise of judicial interpretation to secure, as the Court itself affirms, the constitutionality of the Municipal License Tax Act. Petitioner does not assert in its argument of the second issue presented for review that there exists a constitutional problem with the credit itself, upon a recognition of the credit by the Puerto Rico Supreme Court. The Petitioner merely limits himself to argue, in unreasonable terms, that the Puerto Rico Supreme Court's reading of the statute is a contrivance or device to defeat this Court's jurisdiction.

As well as failing to present a plausible argument that the Puerto Rico Supreme Court's recognition of the credit via judicial interpretation is an unreasonable interpretation of the law, the Petitioner fails to allege facts, judicial precedent or any court opinion that would indicate the recognition of this credit is not a proper exercise of the Puerto Rico Supreme Court's interpretive faculty in reviewing a state law, or that a constitutional transgression or deprivation has been committed by the Puerto Rico Supreme Court's interpretation of the law. The only fact that the Petitioner presents to establish its contention is that the statute does not specifically define "excess payments" as payments made to other states pursuant to such other states' laws. However, it cannot be denied that there is a statutory basis for the Puerto Rico Supreme Court's interpretation: 21 L.P.R.A. 652f(a)(1).

The Puerto Rico Supreme Court, in all practical terms, has developed meaning to the text of the law in the face of new and changing circumstances. The meaning given to the text of the law by the Puerto Rico Supreme Court should be authoritative, particularly considering the absence of any persuasive argument by the Petitioner that there is a widely shared, restrictive, definition of "excess payments" that excludes any other meaning.

Clearly, the Petitioner does not present sufficient facts or any court decisions to warrant review of the Puerto Rico Supreme Court's decision recognizing the credit; a recognition that was accomplished in order to achieve an interpretation which is congruent and compatible with the maintenance of the constitutionality of a law, all of which is in conformance with the judicial discretion that the Puerto Rico Supreme Court has exercised in prior cases[5] and which reflects sound judicial principle. In *Hooper v. California*, 155 U.S. 648, 657 (1895), the Supreme Court of the United States indicated "the elementary rule is that every reasonable construction must be resorted to in order to save a statute from unconstitutionality." In *Rust v. Sullivan*, 500 U.S. ___, 114 L. Ed. 2d 233, 253-254, 111 S. Ct. ___ (1991), this Court affirmed the above principle: "The principle enunciated in *Hooper vs. California*, supra, and subsequent cases is a categorical

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[5] See the Puerto Rico Supreme Court's opinion of *Banco Popular de Puerto Rico v. Municipality of Mayaguez*, P.R. Bar Ass'n. Adv. Sh. 1990-88; 90 JTS 99, mentioning cases of *P.R.P. v. C.W.P.R.*, 115 D.P.R. 631, 642 (1984); *Milan Rodríguez v. Muñoz*, 110 D.P.R. 610, 618 (1981).

one: 'as between two possible interpretations of a statute, by one of which it would be unconstitutional and by the other valid, our plain duty is to adopt that which will save the Act.' *Blodgett vs. Holden*, 275 US 142, 148, 276 US 594, 72 L ED 206, 48 S CT 105 (1927) (opinion of Holmes, J.)."

As Regards The Third Question Presented In The Petition:

III. THE ALLEGATION THAT MATTERS OF NATIONAL CONCERN ARE RAISED IS AN INANE, UNSUBSTANTIATED CONTENTION THAT MUST BE ASSESSED IN LIGHT OF THE PETITIONER'S FAILURE TO SUBSTANTIATE ANY EROSION OF CONSTITUTIONAL PRINCIPLES OR THAT THE PUERTO RICO SUPREME COURT'S DECISION IS IN CONFLICT WITH THE DECISIONS OF THIS COURT.

The Petitioner pretends to convince this Court that review of the Puerto Rico Supreme Court decision is warranted, under the pretext that matters of national concern are presented in a new factual context. However, the contention that matters of national concern are raised must be assessed in light of the Petitioner's failure to substantiate any erosion of constitutional principles enunciated by this Court or that the Puerto Rico Supreme Court has not followed the authoritative pronouncements of this Court.

The Puerto Rico Supreme Court adjudicated the controversies presented before it based upon sound judicial doctrine. The Petitioner's allegations do not sustain the argument that the Puerto Rico Supreme Court's decision

has departed from, or is in conflict with any of this Court's decisions. The temptation of granting a writ based upon an inane, unsubstantiated contention that matters of national concern are raised should be balanced against these factors. In addition, in the absence of a clear showing of a constitutional problem, there should exist the opportunity of state courts, in this case the Puerto Rico Supreme Court, to develop meaning to the principles enunciated by this Court without the need of continued review whenever a different contextual situation is presented. We therefore respectfully submit that judicial repose, instead of judicial scrutiny, is warranted and appropriate in this case.

CONCLUSION

For the reasons stated in this brief, the petition for writ of certiorari should be denied.

Respectfully submitted,

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January 8, 1992.

(3)

No. 91-521

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

BANCO POPULAR DE PUERTO RICO,

Petitioner,

v.

MUNICIPALITY OF MAYAGUEZ,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of Puerto Rico

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PETITIONER'S REPLY TO RESPONDENTS' BRIEFS IN OPPOSITION

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OCTOBER TERM, 1991

No. 91-521

BANCO POPULAR DE PUERTO RICO,

Petitioner,

v.

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Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF PUERTO RICO

PETITIONER'S REPLY TO RESPONDENTS' BRIEFS IN OPPOSITION

Pursuant to Supreme Court Rule 15.6, petitioner replies to respondents' briefs in opposition as follows:

A. Petitioner Does Not Seek Review of Merely State Law Questions

In its brief, pp. 7-8, 10 and 11, respondent Commonwealth of Puerto Rico[1] repeatedly claims that petitioner is merely seeking review of purely state

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[1] Petitioner is somewhat puzzled by the appearance of the Commonwealth of Puerto Rico as "respondent" herein. Brief in opposition 1. As far as petitioner is concerned, the true respondent is the Municipality of Mayaguez, who has in fact filed and served its own brief in opposition.

law questions. This is not correct. What petitioner has shown is that a state statute and regulation, *as finally interpreted by the Supreme Court of Puerto Rico,* have been rendered nugatory under the Commerce Clause. Indeed, "this Court has established that it is bound to accept the interpretation of state law by the highest court of a state," *id.* 7-8; thus, this Court is bound to accept the interpretation of the statute and regulation by the Supreme Court of Puerto Rico which interpretation renders the statute and regulation invalid under the Commerce Clause.

B. The Decision Below is Final and Ripe for Review By This Court

Respondent Commonwealth of Puerto Rico claims that further proceedings before the trial court are expected and therefore "petitioner has not satisfied its obligation to show that the decisions appealed (sic) from have the required finality to warrant review by this Court." *Id.* 9. The only authority cited by said respondent in support of this proposition is "28 U.S.C. 1258." *Id.* (*see also* petition at 2).

Respondent Commonwealth of Puerto Rico nevertheless has conceded that all that is contemplated on remand to the trial court is a matter of mere arithmetic: ". . . determine the amount of taxes paid, if any, by [petitioner] in New York, California and the U.S. Virgin Islands, and for computation of the real tax deficiency in light of this evidence." *Id.* 6. *No further adjudication or review of the federal (Commerce Clause) question involved herein is contemplated.* Therefore, pursuant to firmly established precedent of this Court, the decision below is "final" for purposes of review by this Court. *Cox Broadcasting Corp. v. Cohn,* 420 U.S. 469 (1975); *Abood v.*

Detroit Board of Education, 431 U.S. 209 (1977); *Pennsylvania v. Ritchie*, 480 U.S. 39 (1987); *Mississippi Power & Light Co. v. Moore*, 487 U.S. 354 (1988); *Asarco, Inc. v. Kadish*, 490 U.S. 605 (1989).

C. The Apportionment Formula

Both respondents concede that petitioner operates branches in New York, California and the U.S. Virgin Islands. Comm. Br. 4, 6; Muni. Br. 4. Both respondents coincide in their presentation of the formula for determining petitioner's taxable "volume of business":

Deposits of the bank in the Municipality of Mayaguez	÷	Total deposits of the bank	x Gross income from all sources	= Volume of Business subject to municipal tax in Mayaguez

Comm. Br. 5; Muni. Br. 6.

Both respondents urge this Court to cease further inquiry at this point because, as they allege, said formula is "fair." Comm. Br. 8; Muni. Br. 11.

In so doing, respondents readily admit that the Municipal License Tax is sought to be imposed on "gross income from all sources" regardless of whether or not any part of such income is "attributable" to the taxing jurisdiction. Comm. Br. 8-9; Muni. Br. 9 and 10. Respondent Municipality of Mayaguez recognized that this issue was "avoided" by the Puerto Rico Supreme Court, purportedly "because it was not necessary." Muni. Br. 9. Respondents thus base their claim to "fairness" solely upon the formulaic "apportionment" of such gross income according to the

ratio which deposits in branches within the municipality may bear to the "total deposits of the bank."[2]

This apparently simple solution is defective for the following reasons:

First: Article 2(7)(B) of Regulation No. 3142 specifies that taxable gross income of banks includes all kinds of "income derived from any . . . source within or outside of Puerto Rico, attributable to the operation in Puerto Rico." Pet. 5-6. The Puerto Rico Supreme Court, in both its 1988 and 1990 opinions, stressed that it is only income which is "received" in Puerto Rico that is to be considered taxable. Ap. 8a, 9a, 21a, 22a. It would not be necessary to consider whether income is "attributable" to or "received" in Puerto Rico if *all* income were to be indiscriminately included in the tax base which is then apportioned among the various municipalities.

Second: The 1990 opinion of the Puerto Rico Supreme Court is inconsistent in its expression of the deposit ratio, at times stating that the total deposits of the bank, wherever located, must be included in the denominator, but at one point limiting said base to "total deposits of the financial organization *in Puerto Rico*" (Ap. 22a; emphasized). This inconsistency is not insignificant: the Municipal License Tax

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[2] Respondent Municipality of Mayaguez even goes as far as claiming that the apportionment formula is not only "fair," but also that it "does not require a tax credit provision for it to be constitutional." Muni. Br. 11. In this respect, respondent Municipality of Mayaguez contradicts respondent Commonwealth, who has steadfastly argued that it is precisely the Puerto Rico Supreme Court's recognition of the alleged tax credit which saved the day and rendered the otherwise invalid statute and regulation constitutional. Comm. Br. 5, 7, 8, 10.

Act was recently amended to adopt the latter definition of the deposit ratio. Act No. 82 of August 30, 1991. Article 1 of Act No. 82 amends the 1974 statute to read, in its pertinent portion, as follows (new language underscored; compare Pet. 8a):

> In the specific case of commercial banks and savings and loan associations, mutual savings bank, gross revenue will mean the interest received or earned from loans, the service charges, the revenue, the gross earnings from the sale of properties or securities, and the profits, earnings and income derived from any other origin *within and outside Puerto Rico attributable to the operation in Puerto Rico.*
>
> The gross income derived from these organizations subject to the payment of gross receipts tax will be distributed among the branches according to the proportion all the types of deposits of the branch bear to the total deposits of the organization *in Puerto Rico.*

Petitioner contends that, even assuming, *arguendo,* that the deposit ratio governs the determination of its taxable gross income, any apportionment formula which includes *all* foreign source income but then excludes *all* foreign deposits can hardly be considered "fair" or in compliance with the Commerce Clause.

Petitioner readily concedes that the Commerce Clause does not compel any particular, specific apportionment formula for taxation of income derived from interstate commerce. However, it is also clear that the Commerce Clause precludes any apportion-

ment formula which is at once ambiguous in its definition of taxable income and wholly devoid of an effective allocation formula.

In this instance, an uncertain deposit ratio is sought to be applied, as the sole factor, to a determination of petitioner's taxable income and resulting tax liability. Petitioner respectfully requests that certiorari be granted herein to consider the question of the validity under the Commerce Clause of such a tax on income derived from the interstate conduct of its banking business

D. Conclusion and Relief Sought

This Court should issue a writ of certiorari to review the 1988 and 1990 decisions and 1991 order of the Puerto Rico Supreme Court, as petitioner hereby very respectfully demands.

Respectfully submitted.

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